FRIDAY
October 28
2022

BOYS TOWN CONFERENCE CENTER
14100 CRAWFORD ST. ▪ BOYS TOWN, NE 68010
7:30 A.M. TO 12:30 P.M.

The 13th

Yale Richards Professional Education Seminar

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Jewish Federation of Omaha Foundation

Welcome to the 2022 Yale Richards Professional Education Seminar! We are thrilled that you are here! I would like to extend a special thanks to our Advisory Committee whose valuable advice and input helped to make today a success:

Mike N. Abramson
Frankel Zacharia

John B. Atkins
Union Bank & Trust Company

Jeremy Belsky
Boys Town

Scott C. Berryman
Carson Wealth

James A. Farber
Swartzbaugh-Farber & Associates, Inc.

Myron Kaplan
McGill, Gotsdiner,Workman & Lepp

Robert Kully
Kully Financial Services

Robert B. Wellendorf II
Execso

David P. Wilson
Walentine O'Toole, LLP

Special thanks go to **Jeremy Belsky** who has been a valued partner in planning the Yale Richards seminar and in arranging for Boys Town's co-sponsorship, including the use of the Boys Town Conference Center and providing the meals.

I would like to thank the **Milton S. & Corinne N. Livingston Foundation** for establishing the Yale Richards Professional Education Endowment Fund in 1998. That endowment enables us to fully fund each seminar.

Finally, I want to extend my appreciation to Diane Walker and the rest of our Foundation staff: Laurie Peatrowsky, Linda Pollard and Jay Katelman for their time, effort, and expertise to make this a successful seminar.

To obtain **Continuing Education Credits**, please see the information on the following page.

We hope you enjoy the speakers! Thank you so much for attending!

Howard N. Epstein
Executive Director (Emeritus)
Jewish Federation of Omaha Foundation

<u>Continuing Education Information</u>

PLEASE MAKE SURE TO <u>SIGN IN AND OUT</u> AT THE REGISTRATION TABLE IN ORDER TO QUALIFY FOR CREDITS

Activity & Course #s:
CPE (Accountants) – Course #22-235 (Approved for 4 hours; includes 1 hour of Ethics)
CLE (Attorneys) – Activity# 235039 (Approved for 4 hours; includes 1 hour of Ethics)
CE (Insurance) – Course # 6000131724 (Approved for 4 hours Life; 1 hour of Ethics)
CFP (Financial Planners) – Program ID# 306109/306114/306108 (Approved for 4 ½ hours)
CAP (Recertification) – 5 Hours

Please see Diane Walker at the registration table if you have any questions.

You can also contact her at:

Diane Walker
Fund & Scholarship Administrator
Jewish Federation of Omaha Foundation
402-334-6551
dwalker@jewishomaha.org

Seminar Agenda & Table of Contents

7:30 a.m. – 8:00 a.m. **Registration and Full Continental Breakfast**

8:00 a.m. – 8:10 a.m. **Welcome / Introductions**
Howard N. Epstein, Executive Director (Emeritus), Jewish Federation of Omaha Foundation
Fr. Steven E. Boes, National Executive Director, Boys Town
David P. Wilson, Yale Richards Seminar Advisory Committee Member, Walentine O'Toole, LLP

Speaker – Christopher R. Hoyt, JD

Jewish Federation of Omaha Foundation

BOYS TOWN® Saving Children Healing Families

RETIREMENT ACCOUNTS:
PLANNING OPTIMAL OUTCOMES
FOR FAMILY AND CHARITABLE OBJECTIVES

THE YALE RICHARDS
PROFESSIONAL EDUCATIONAL SEMINAR
Boy's Town Conference Center – Omaha, Nebraska
October 28, 2022

CHRISTOPHER R. HOYT
University of Missouri - Kansas City
School of Law

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What Will Be Covered Today:

- Rules and planning implications for distributions from retirement accounts
- Outcomes and planning strategies when the beneficiary of a retirement account is a trust
  -- Special considerations for a tax-exempt CRT
- What are the legal rights that a spouse has in the other spouse's retirement assets?
  -- Rules are different for 401(k) plans and IRAs
- Tax-smart charitable giving in 2022

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REQUIRED MINIMUM DISTRIBUTIONS
LIFETIME DISTRIBUTIONS

TWO CHANGES FOR LIFETIME RMDs:

1. **New RMD Age : 72**
   ("SECURE 2.0" proposal- RMD at ages 73, 74 & 75)
   (Despite new age 72, charitable QCD still 70 ½)

2. **New life expectancy tables (beginning in 2022)**
   Annual RMD amounts have declined by between 0.3% and 0.5% (varies by age)

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REQUIRED MINIMUM DISTRIBUTIONS
*LIFETIME DISTRIBUTIONS – YEAR 2021

Age of Account Owner	Required Payout
72	3.91%
75	4.37%
80	5.35%
85	6.76%
90	8.75%
95	11.63%
100	15.88%

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REQUIRED MINIMUM DISTRIBUTIONS
*LIFETIME DISTRIBUTIONS – YEAR 2022 *

Age of Account Owner	Required Payout
72	3.67%
75	4.07%
80	4.95%
85	6.25%
90	8.27%
95	11.24%
100	15.71%

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Stretch IRA

- "Stretch IRA" means an inherited retirement account (e.g., IRA), where payments are gradually made over the beneficiary's life expectancy
- Until the enactment of the SECURE Act, it was fairly easy for any beneficiary who inherited a retirement account to receive distributions until the age of 83 (or older for beneficiaries who inherited at an older age)
- New rules apply beginning in year 2020

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Why do people want a long stretch?

When administering a decedent's estate,
isn't the usual objective to close the estate within a year of death and have everything distributed to the heirs and the beneficiaries?

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Distributions from Inherited Retirement Accounts Are Taxable Income

Income In Respect of A Decedent "IRD" –§691

- No stepped up basis for retirement assets
- Distributions from inherited retirement accounts are usually taxable income to the beneficiaries.

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USUAL OBJECTIVE: Defer paying income taxes in order to get greater cash flow

	Principal	10% Yield
• Pre-Tax Amount	$ 100,000	$ 10,000
• Income Tax on Distribution (40%)	40,000	
• Amount Left to Invest	$ 60,000	$ 6,000

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Distributions After Death
(for decedents who die in 2020 and later)

Maximum time period to empty account:

- **Ten years**

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RETIREMENT ACCOUNTS IN MARRIAGES: TYPES OF QRPs

- Section 401(a) - Employer pension, profit sharing and stock bonus plans[*incl. 401(k)*]
- Section 408 – IRAs
- Section 403(b) - School and charity employers
- Section 457(b) plans - Government and tax-exempt employers

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Distributions After Death

Company policy may require faster liquidation

- Employer might require account of deceased employee to liquidated in just one year
- No such problem with IRAs
- Beneficiary of employer plan account can compel transfer to an inherited IRA

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Distributions After Death

(for decedents who die in 2020 and later)

<u>Maximum time period to empty account:</u>

- **Ten years**

2022 Proposed Regulations

- Death ***before*** "required beginning date"? (e.g., before age 73)
  - No required distributions in the first nine years. The account needs to be empty by December 31 of the tenth year after the year of the decedent' death, or else there is a 50% penalty on the balance]
- Death ***after*** "required beginning date"? (e.g., after age 72)
  - The proposed regs will require the beneficiary to receive minimum distributions every year in years 1 through 9, and the account must be empty at the end of the tenth year.

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These are only proposed regs. Some argue that the final regs should not require any RMDs until the tenth year. Legislative intent.

- *October 2022*: IRS announces it will NOT apply this RMD rule in years 2021 or 2022. IRS Notice 2022-53 (October 7, 2022).

The IRS Notice states

IV. Guidance for Certain RMDs for 2021 and 2022

- **B. Guidance for certain taxpayers who did not take a specified RMD**

To the extent a taxpayer did not take a ***specified RMD*** [defined below], **the IRS will not assert that an excise tax is due under section 4974….**

- **C. Definition of specified RMD**
- For purposes of this notice only, a ***specified RMD*** is any distribution that, under the interpretation included in the proposed regulations, would be required to be made pursuant to section 401(a)(9) in 2021 **or** 2022 under a defined contribution plan or IRA that is subject to the rules of 401(a)(9)(H) for the year in which the employee (or designated beneficiary) died if that payment would be required to be made to:
- a designated beneficiary of an employee under the plan (or IRA owner) if:
  - (1) the employee (or IRA owner) **<u>died in 2020 or 2021</u>** and **<u>on or after the employee's (or IRA owner's) required beginning date</u>,** and
  - (2) the designated beneficiary is ***not*** taking lifetime or life expectancy payments pursuant to section 401(a)(9)(B)(iii);...

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Distributions After Death

(for decedents who die in 2020 and later)

<u>Maximum time period to empty account:</u>

- **Ten years, *or***
- **Remaining life expectancy of an *"eligible designated beneficiary"*** *(RMD every year)*

  -- surviving spouse -- minor child of the decedent

  -- disabled individual -- chronically ill person

  -- beneficiary within 10 years of age of decedent

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LIQUIDATE INHERITED IRAs IN TEN YEARS

EXCEPTION: "*<u>Eligible</u> Designated Beneficiary*"

- *-- surviving spouse* *-- minor child of the decedent*
- *-- disabled individual* *-- chronically ill person*
- *-- beneficiary within 10 years of age of decedent*

An ***eligible*** designated beneficiary may take distributions over her/his life expectancy *

* When minor child attains majority, the 10 year clock starts

* When an EDB dies, the 10 year clock starts for successor

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Distributions After Death

(for decedents who die in 2020 and later)

<u>Maximum time period to empty account:</u>

- **Ten years,** ***or***
- **Remaining life expectancy of an "*eligible designated beneficiary*", or**
- **Five Years, or**
- **"Ghost life expectancy"**

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REQUIRED MINIMUM DISTRIBUTIONS

*<u>*Ghost Life Expectancy*</u>*

Age of Beneficiary		Life Expectancy
74	*6.4%*	15.6 more years
75	*6.8%*	14.8
76	*7.1%*	14.0
77	*7.5%*	13.3
78	*7.9%*	12.6
78	*8.4%*	11.9
80	*8.9%*	11.2

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Distributions After Death
(for decedents who die in 2020 and later)

Maximum time period to empty account:

- **Ten years, *or***
- **Remaining life expectancy of an "*eligible designated beneficiary*", or**
- **Five Years, or**
- **"Ghost life expectancy"**

If on "determination date", EVERY beneficiary is a human being
(designated beneficiary)

If on "determination date", there is a beneficiary that is not a human being

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REQUIRED MINIMUM DISTRIBUTIONS
* *DEFINITIONS* *

- **Required Beginning Date ("RBD")**
  April 1 in year after attain age 72
- **Designated Beneficiary ("DB")**
  A human being. An **estate** or **charity** can be a beneficiary of an account, **but not a DB**.
- **Determination Date**
  September 30 in **year <u>after</u> death.**

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REQUIRED DISTRIBUTIONS IF THERE IS EVEN JUST ONE NON-DESIGNATED BENEFICIARY

<u>Death Before RBD</u>	<u>Death After RBD</u>
FIVE YEARS	Remaining life expectancy of someone who is decedent's age at death
[No RMD until year #5]	***[Each year has an RMD]*** ***["ghost life expectancy"]***

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REQUIRED DISTRIBUTIONS
IF THERE IS EVEN JUST ONE
NON-DESIGNATED BENEFICIARY

Death Before RBD	Death After RBD
FIVE YEARS	~~Remaining life expec... some... is decedent's age at death~~
	Roth IRA: Just 5 years

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ACTIONS THAT CAN BE TAKEN
BEFORE THE DETERMINATION DATE

- Disclaimers
- Full distribution of share
- Divide into separate accounts

For example, separate accounts when:
- one beneficiary is an EDB and another is not
- one beneficiary is a charity & can't pay by 9/30

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LIQUIDATE INHERITED IRAs IN TEN YEARS

SECURE ACT - EFFECTIVE DATES:

* Rules apply for decedents dying after December 31, 2019

* For decedents who died ***before 2020***, beneficiaries can continue to receive payments over remaining life expectancy.

- However, upon the death of that beneficiary, the 10 year clock starts ticking.
- EXAMPLE: A 60 year old beneficiary inherited an IRA in 2019 when he had a life expectancy to age 85 (for 25 years). That beneficiary dies 2 years later at age 62. The inherited IRA must be empty in the 10^{th} year after death [rather than the year that the individual would have been age 85]

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MARRIED COUPLES:
RETIREMENT ASSETS

Surviving spouse has an option that no other beneficiary has:

a ***rollover*** of deceased spouse's retirement assets to her or his own new IRA (creditor protection, too!)

Other beneficiaries cannot do a rollover.

Main option: liquidate over ten years

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LEAVE $ IN DECEASED SPOUSES' ACCOUNT?

- Generally, a rollover produces greater income tax deferral than leaving assets in the decedent's account
- Two situations when it may be advisable to leave some assets in the decedent's account (at least for a while)

➢Surviving spouse is under age 59 ½

➢Deceased spouse was under age 72, and surviving spouse is past that age (e.g., deceased was age 68 and survivor is age 74)

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LEAVE MONEY IN DECEDENT'S ACCOUNT?
Required Distributions if the
Surviving Spouse is the Sole Beneficiary

- Spouse can recalculate life expectancy
- IRAs only: Spouse can elect to treat IRA as her own
- Decedent died before age 72 ?
  - No required distribution until year the deceased spouse would have been age 72

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Distributions After Death

" life expectancy"

Oversimplified: Half of population will die before that age, and half will die after

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REQUIRED MIN. DISTRIBUTIONS
LIFE EXPECTANCY TABLE
"STRETCH IRAS - LAW BEFORE 2020"

Age of Beneficiary		Life Expectancy
30	*1.9%*	53.3 more years
40	*2.3%*	43.6
50	*2.9%*	34.2
60	*4.0%*	25.2
70	*5.3%*	18.7
80	*8.9%*	11.2
90	*17.5%*	5.7

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REQUIRED MINIMUM DISTRIBUTIONS
Example: Death at age 80?
NEW LAW: TEN YEARS (if >10 year younger)

Age of Beneficiary		Life Expectancy
30		10 years
40		10
50		10
60		10
70	*5.3%*	18.7
80	*8.9%*	11.2
90	*8.9%*	5.7 * [11.2 yrs]

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LIQUIDATE INHERITED IRAs IN TEN YEARS

STRATEGIES:

- **Lotsa beneficiaries! Share the love! Spread the wealth!**
  Example: Children and grandchildren, rather than just children
- **Lifetime Roth IRA conversions, if current income tax rate is likely to be less than future tax rates**
- **Are any beneficiaries "eligible designated beneficiaries"?**
- **Charitable bequests**
  * Have pre-tax dollars used for charitable purposes,
  especially if estate will be subject to federal or state estate taxes
  * Charitable remainder trusts (more on this later)

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Outcomes and planning strategies when the beneficiary of a retirement account is a trust

- Definitions
  - "See-through" trust
  - Conduit trust vs. Accumulation trust
- Ways to have income taxed at individual income tax rates (rather than trust's 37% rate)
- Case study: IRA payable to a trust for a surviving spouse and for children from a prior marriage
- Naming a tax-exempt CRT as a beneficiary

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IRAs PAYABLE TO TRUSTS

General Rule: Trust is not a DB

As is the case when the probate estate is the beneficiary, the *general rule* is that naming a trust as the beneficiary means that there is "no designated beneficiary", and the account may have to be liquidated in just five years.

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IRAs PAYABLE TO TRUSTS

General Rule: Trust is not DB

Exception: "See-through" trust if four conditions are met. Reg. § 1.409(a)(9)-4, Q&A 5 & 6

- (1) The trust is a valid trust under state law
- (2) The trust is irrevocable (or will become irrevocable on death)
- (3) The beneficiaries are identifiable from the trust instrument,
- (4) A document is given to the plan administrator. Either:
  (a) a copy of the entire trust instrument or
  (b) a certified list of all of the beneficiaries of the trust

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IRAs PAYABLE TO TRUSTS

General Rule: Trust is not DB

Exception: "See-through" trust if four conditions are met. Reg. § 1.409(a)(9)-4, Q&A 5 & 6

Types:-- ***"accumulation trusts"***

-- "***conduit trusts***"

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CONDUIT TRUSTS

- Defined: Where the governing instrument provides that all amounts distributed from the retirement account to the trustee while the primary beneficiary is alive will, upon receipt by the trustee, be paid directly from the trust to that beneficiary. Reg. § 1.409(a)(9)-5, Q&A 7(c)(3), Example 2.
- Advantage of a conduit trust: The *conduit beneficiary* is considered to be the *sole beneficiary* of that trust. The RMD computation ignores beneficiaries who will receive retirement plan $$ after the conduit beneficiary dies.

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ACCUMULATION TRUSTS

- Defined: A trust where the trustee has the power to either distribute or retain distributions that the trustee receives from a retirement plan account. Reg. § 1.409(a)(9)-5, Q&A 7(c)(1)
- If retained, the income tax rate will likely be 37%
  - There is no requirement to keep the money in an accumulation trust.
  - Some estate planners name an accumulation trust as the beneficiary to provide asset protection (divorce, etc.) for up to 10 years.
  - They plan to have the trust distribute all of the retirement plan income to the beneficiary over 10 years, so the income will be taxed at a lower income tax rate.

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ACCUMULATION TRUSTS

Effect of remainder beneficiaries:

- **Generally, all beneficiaries of an accumulation trust are considered** for the RMD computation. Prop. Reg. §1.401(a)(9)-4(f)(3); PLR 200228025 (Apr. 18, 2002)
- Problem when some beneficiaries are EDBs and others are not EDBs:
  - the EDB may have to receive all assets in just ten years rather than over the longer time period of the EDB's remaining life expectancy.

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ACCUMULATION TRUSTS

Effect of remainder beneficiaries:

- Generally, all beneficiaries are considered for the RMD computation. Prop. Reg. §1.401(a)(9)-4(f)(3); PLR 200228025 (Apr. 18, 2002)
- Exception: Accumulation trust for disabled & chronically ill (e.g., special needs trust)
  - *§401(a)(9)(H)(v) APPLICABLE MULTI-BENEFICIARY TRUST*
- **Exception: remote contingent beneficiary** (charity)
  - Example: *"First to "A", then to "B", then to "C", then to "D".*
  - One can disregard "C" and "D"; only "A" and "B" matter
  - Prop. Reg. §1.401(a)(9)-4(f)(3)(ii)(A) - *[(ii) Certain trust beneficiaries disregarded* -- ***(A) Entitlement conditioned on death of secondary beneficiary.]***

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ACCUMULATION TRUSTS

Effect of remainder beneficiaries:

- Generally, all beneficiaries are considered for the RMD computation. Prop. Reg. §1.401(a)(9)-4(f)(3); PLR 200228025 (Apr. 18, 2002)
- Exception: Accumulation trust for disabled & chronically ill (e.g., special needs trust)
  - *§401(a)(9)(H)(v) APPLICABLE MULTI-BENEFICIARY TRUST*
- **Another Exception: "Age 31 trust"**
  - The proposed regs would disregard remainder beneficiaries of a trust for ***any*** minor child if retirement benefits must be distributed to that beneficiary by age 31.
  - Prop. Reg. §1.401(a)(9)-4(f)(3)(ii)(B) - *[(ii) Certain trust beneficiaries disregarded --**(B) Entitlement conditioned on death of young individual.]***

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IRAs PAYABLE TO TRUSTS

- Payable to a conduit trust?
- Payable to an accumulation trust?

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CONDUIT TRUSTS

- *Unless* the beneficiary is an *eligible* designated beneficiary, the retirement account will be fully liquidated in ten years. The beneficiary will personally own all of the retirement assets.
- So what are the advantages of naming a conduit trust as the beneficiary, compared to simply naming the individual as the beneficiary on the IRA/retirement plan beneficiary form?

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ACCUMULATION TRUSTS

- Trusts pay the highest income tax rate: 37%.
  Will the beneficiaries be in a much lower income tax bracket?
- If so, will the benefits of the trust outweigh the much higher income tax cost?
- Benefits include:
  * Asset protection * Professional management
  * Restricted withdrawals by spendthrift beneficiaries

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Three Ways for Retirement Assets That Were Distributed to a Trust to be Taxed at the Lower Individual Tax Rates

- An accumulation trust (or a conduit trust) that distributes the retirement plan income to the individuals over the required ten years
- Beneficiary Deemed Owner Trust (BDOT)

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Beneficiary Deemed Owner Trust (BDOT)

- A "grantor trust," where the income of the trust is taxed to the *beneficiary* under §678(a)
- The beneficiary is usually in a lower income tax bracket than the trust's 37%. Trust distributes cash to pay tax.
- Beneficiary is given a withdrawal power over the taxable income of the trust. But no withdrawal power over the principal. This provides asset protection and other benefits for the assets retained in the trust.
  Not perfect, of course. Wouldn't want to have a withdrawal power for a substance abuser or when trying to qualify for public assistance with a special-needs beneficiary
- Comprehensive article by Ed Morrow: Google search: SSRN BDOT

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Three Ways for Retirement Assets That Were Distributed to a Trust to be Taxed at the Lower Individual Tax Rates

- An accumulation trust (or a conduit trust) that distributes the retirement plan income to the individuals over the required ten years
- Beneficiary Deemed Owner Trust (BDOT)
- A charitable remainder trust
  - The distributions from the CRT will be taxed to the CRT beneficiaries under the "four-tier" system only in the future years that the CRT beneficiaries receive them

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MANDATORY DISTRIBUTIONS
[Assume inherit IRA at age 80 and die at 94]

EXAMPLE: D. John Mustard owned three IRAs when he died this year at age 91. His surviving spouse, Honey, turned age 80 the year after his death. Each IRA had a different beneficiary:

- An accumulation trust for Honey, remainder to his children from his first marriage
- A conduit trust for Honey, remainder to his children from his first marriage
- Honey was the sole beneficiary (rollover is possible)

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MANDATORY DISTRIBUTIONS
[Assume inherit IRA at age 80 and die at 94]

<u>**AGE**</u>

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Husband's RMD in the year of death

Prop. Reg. § 1.402(c)-2(j)(3)

- **If the deceased owner had not withdrawn the entire RMD before the date of death, the balance must be distributed to *the beneficiary* of the IRA that year.**
- *[Proposed Regs have a grace period if full distribution wasn't taken in year of death: beneficiary can receive next year if before beneficiary's tax return filing deadline. Prop Reg § 54.4974-1(g)(3)]*

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SECURE Act (2019)
When enacted, most believed no RMDs in years 1 through 9
But the 2022 proposed regulations would require RMDs
if the IRA Owner (or employee) died after the RBD.

AGE	Trust	
81		
85		
90	100.00%	<< 10 years, since it is
91	empty	an accumulation trust
92	empty	

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Prop. Reg. §1.401(a)(9)-5(d)(1) (2022)
Required minimum distributions from defined contribution plans.

EXPLANATION FROM THE PREAMBLE TO THE REGS:

"For example, if an employee died ***after the required beginning date*** with a designated beneficiary who is not an eligible designated beneficiary, then the designated beneficiary would continue to have required minimum distributions calculated using the ***beneficiary's*** life expectancy as under the existing regulations **for up to nine calendar years after the employee's death.** In the tenth year following the calendar year of the employee's death, a full distribution of the employee's remaining interest would be required."

But would this rule apply to Honey? Honey is the surviving spouse. And a surviving spouse is an "eligible designated beneficiary"

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Prop. Reg. §1.401(a)(9)-5(d)(1) (2022)
Required minimum distributions from defined contribution plans.

EXPLANATION FROM THE PREAMBLE TO THE REGS:

"these proposed regulations provide a general rule under which, if an employee has more than one designated beneficiary, and at least one of them is *<u>not</u>* an eligible designated beneficiary, then for purposes of section 401(a)(9), the employee is treated as not having an *eligible* designated beneficiary. As a result, the employee's interest must be distributed no later than the end of the tenth calendar year following the calendar year of the employee's death."

Sorry, Honey! The adult children from the first marriage are also considered. So these payout rules *will* apply to you.

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Age 81: 1/10.5 =
Age 82: 1/ 9.5 =
Age 83: 1/ 8.5 =

AGE	RMD %
81	
82	
83	
84	
85	
86	
87	
88	
89	
90	**100.0%**

AGE	Life Expectancy
80	11.2 years
81	**10.5 years**
82	9.9 years
83	9.2 years

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Age 81: 1/10.5 =
Age 82: 1/ 9.5 =
Age 83: 1/ 8.5 =

AGE	RMD %
81	**9.5%**
82	10.5%
83	11.8%
84	13.3%
85	**15.4%**
86	18.2%
87	22.2%
88	28.6%
89	40.0%
90	**100.0%**

AGE	Life Expectancy
80	11.2 years
81	**10.5 years**
82	9.9 years
83	9.2 years

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RMDs ARE LESS BURDENSOME FOR YOUNGER BENEFICIARIES (e.g., children)

Age of Beneficiary		Life Expectancy
30	*1.9%*	**53.3 more years**
40		**43.6**
50	*2.9%*	**34.2**
60		**25.2**
70	*5.3%*	**18.7**
81	*9.5%*	**10.5**

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MANDATORY DISTRIBUTIONS
[Assume inherit IRA at age 80 and die at 92]

AGE	Accumulation Trust
81	9.52%
85	15.38%
90	100.00%
91	empty
92	empty

Under the 2022 proposed regulations, the "designated beneficiary" would have to receive RMDs over each of the nine years after death, and the account would have to be liquidated in the tenth year.
WHY?
Because death occurred ***after*** the "required beginning date"

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MANDATORY DISTRIBUTIONS
[Assume inherit IRA at age 80 and die at 92]

AGE	Accumulation Trust
81	-- 0%--
85	-- 0%--
90	100.00%
91	empty
92	empty

Question: Under the 2022 proposed regulations, what are the required distributions if death occurred ***before*** the "required beginning date"?

Answer: there are no RMDs in years one through nine.

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PLANNING FOR A SURVIVING SPOUSE

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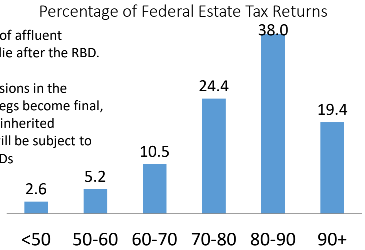
AGE AT DEATH

Percentage of Federal Estate Tax Returns

A majority of affluent taxpayers die after the RBD.

If the provisions in the proposed regs become final, most large inherited accounts will be subject to annual RMDs



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MANDATORY DISTRIBUTIONS
[Assume inherit IRA at age 80 and die at 94]

D. John Mustard owned three IRAs when he died this year at age 91. His surviving spouse, Honey, was age 80 the year that he died. Each IRA had a different beneficiary:

- An ***accumulation trust*** for Honey, remainder to his children from his first marriage
- A ***conduit trust*** for Honey, remainder to his children from his first marriage
- ***Honey*** was the sole beneficiary (**rollover** is possible)

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REQUIRED MINIMUM DISTRIBUTIONS
CONDUIT vs. ACCUMULATION TRUST

1. **Conduit trust permits an EDB to receive distributions over remaining life expectancy**
   (There are RMDs every year)
2. **Surviving spouse can annually recompute remaining life expectancy**

Age of Beneficiary	Life Expectancy
80	**11.2 more years**
90	**5.7 more years**

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MANDATORY DISTRIBUTIONS
[Assume inherit IRA at age 80 and die at 94]

AGE	ROLL - OVER	Accumulation Trust	Conduit Trust .
81	5.19%	9.52%	9.52%
85	6.25%	15.38 %	12.35%
90	8.26%	100.00%	17.54%
91	8.77%	empty	18.87%
92	9.26%	empty	20.41%

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MANDATORY DISTRIBUTIONS

D. John Mustard owned three IRAs when he died this year at age 91. His surviving spouse, Honey, was age 80 the year that he died. Each IRA had a different beneficiary:

- An ***accumulation trust*** for Honey, remainder to his children from his first marriage

Wait a minute!
I heard that even when an IRA is payable to a trust or to the probate estate, the IRS will permit a surviving spouse to rollover the IRA into their own personal IRA. Is that true?
ANSWER: That is true in some situations. But it probably doesn't apply to this trust since the children from his first marriage are also beneficiaries of this trust.

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IRS PLRs: Surviving Spouse *Rollover*

20+ IRS Private Letter Rulings – 2015-2022

Surviving spouse can rollover deceased spouse's IRA, even when the account is payable to:

- **Trust for the spouse**
- **The estate, with estate pour-over into a trust for the spouse**
- **The estate, where the spouse is the sole or residuary beneficiary of the estate**

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Surviving Spouse Can Rollover IRA Payable to Probate Estate
PLR 202210016 (Dec. 12, 2021)

- Decedent "A" designated Decedent A's estate (Estate "E") as the beneficiary of IRA "X."
- Decedent's will named Decedent's spouse ("B") as the sole personal representative and sole residuary beneficiary of the Estate.
- As sole administrator of Estate E, Taxpayer B intends to pay the entire proceeds of IRA X to Estate E, and then to receive the proceeds as residuary beneficiary of Estate E. Taxpayer B intends to roll over the proceeds, within 60 days of the date the proceeds are paid to Estate E, to an IRA maintained in Taxpayer B's name.

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Surviving Spouse Can Rollover IRA Payable to Probate Estate
PLR 202210016 (Dec. 12, 2021)

- Generally, if a decedent's IRA proceeds pass through a third party (for example, an estate) and then are distributed to the decedent's surviving spouse, the surviving spouse will be treated as having received the IRA proceeds from the third party and *not* from the decedent's IRA. Thus, **generally, a surviving spouse will *not* be eligible to roll over the IRA proceeds into the surviving spouse's own IRA.**
- **However, the general rule will _*not apply*_** in situations in which the decedent's estate is the beneficiary of a decedent's IRA proceeds, and the **decedent's surviving spouse is the sole administrator of the estate and the sole beneficiary of the IRA proceeds that pass through the estate.** Under these circumstances no third party can prevent the surviving spouse from receiving the proceeds of the IRA and from rolling over the proceeds into the surviving spouse's own IRA.

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Surviving Spouse Can Rollover IRA Payable to Probate Estate
PLR 202210016 (Dec. 12, 2021)

Rulings. Thus, with respect to your ruling requests, we conclude as follows:

- 1. Taxpayer B will be treated for purposes of section 408(d)(1) and (d)(3) as the payee or distributee of the proceeds from IRA X.
- 2. IRA X will not be treated as an inherited IRA …with respect to Taxpayer B.
- 3. Taxpayer B will be eligible to roll over the proceeds from IRA X into an IRA or IRAs set up and maintained in Taxpayer B's name, as long as the rollover occurs no later than the 60th day after the date the proceeds are paid to Estate E
- 4. …Taxpayer B will not be required to include in Taxpayer B's gross income any portion of the IRA X proceeds timely rolled over to an IRA set up and maintained in Taxpayer B's name

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IRS PLRs: Surviving Spouse *Rollover*

IS A PLR NECESSARY?

- IRS user fee for PLR now $28,300 (2015)
  - PLR on IRA issues now $10,000 (2016)
- ACTEC: "public needs a Revenue Ruling"
- Some trustees willing to do rollover without a PLR, if facts fit the PLRs

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MANDATORY DISTRIBUTIONS

[Assume inherit IRA at age 80 and die at 94]

D. John Mustard owned three IRAs when he died this year at age 91. His surviving spouse, Honey, was age 80 the year that he died. Each IRA had a different beneficiary:

- An accumulation trust for Honey, remainder to his children from his first marriage

The spouse's rollover option probably doesn't apply to this trust since **the children from his first marriage are also beneficiaries of the trust.**
[*They could object to a rollover to step-mom's IRA*]
BUT IF THE REMAINDER BENEFICIARIES ARE CHILDREN FROM THIS MARRIAGE: they could **disclaim** their interest in the retirement assets, and thereby permit their mother to do a rollover.
PLRs 201901005 (Oct. 10, 2018) and 200934036 (April 29, 2009)

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Stretch IRA

- "Stretch IRA" means an inherited retirement account (e.g., IRA), where payments are gradually made over the beneficiary's life expectancy
- Until the enactment of the SECURE Act, it was fairly easy for any beneficiary who inherited a retirement account to receive distributions until the age of 83 (or older for beneficiaries who inherited at an older age)
- **Beginning 2020: General rule is a ten year liquidation**
- Inherited IRA distributions are taxable income
- *A $1million IRA will shrink to $700k in 10 years* (oversimplified)

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Stretch IRA

- "Stretch IRA" means an inherited retirement account (e.g., IRA), where payments are gradually made over the beneficiary's life expectancy
- Until the enactment of the SECURE Act, it was fairly easy for any beneficiary who inherited a retirement account to receive distributions until the age of 83 (or older for beneficiaries who inherited at an older age)
- Beginning 2020: General rule is a ten year liquidation
- Inherited IRA distributions are taxable income
- ***"Would you like your descendants to be able to get an income stream from all of your retirement assets for the rest of their lives?"***

70

CHARITABLE REMAINDER TRUST

- Payment to non-charitable beneficiary (ies) for *life* *or* for a *term of years*
  (maximum 20 years)
- Remainder interest distributed to charity
- ***Exempt from income tax***

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LIQUIDATE INHERITED IRAs IN TEN YEARS

IMPLICATIONS FOR CHARITIES

Donors more likely to consider

- Outright bequests
- Retirement assets to tax-exempt CRT
  - Child: income more than 5 years; then charity
  - Spouse & children (no estate tax marital deduction)

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2-GENERATION
CHARITABLE REMAINDER UNITRUST

- Typically pays 5% to the surviving spouse for life, then 5% to children for life, then liquidates to charity
- Like an IRA, a CRT is exempt from income tax
- Can be like ***a QTIP trust for IRD assets***

[but no estate tax marital deduction]

73

Theory: Tax advantage of income tax deferral !

Move IRD tax-free after death from one tax exempt trust (e.g., the IRA) to another tax-exempt trust (the CRT).
It can be done!   PLR 199901023.   No taxable income to beneficiaries until they receive distributions from CRT

*[**compare:***
a charitable lead trust is NOT tax-exempt;
don't name a CLT as an IRA beneficiary !]

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Can a CRT Produce More Family Wealth
Than a Ten Year Liquidation?

Yes. It is possible. But usually not likely.

- It can happen with long-term CRUTS (e.g., 40 or 50 years) and beneficiaries who pay high income tax rates
- Outcomes vary with investment returns and tax rates
- CRT can beat leaving outright to children when both:
  - There will be a high income tax rate imposed on the distributions after death, and
  - The CRT will have a long term (e.g., at least 30 years)

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Can a CRT Produce More Family Wealth Than a Ten Year Liquidation?

5% CRUT -- Investments earn 5% -- Tax rate: 40%					
			5% Annual		
			Income	*Consume*	*Save*
CRT	$1,000,000		**$50,000**	*$30,000*	*$20,000*
Income tax	-400,000		*Income tax >>>*		*-$8,000*
			Net annual investment		***$12,000***
After-tax	**$600,000**	*Purchase $600k life insurance?*			**<50 years?**

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Can a CRT Produce More Family Wealth Than a Ten Year Liquidation?

5% CRUT -- Investments earn 5% -- Tax rate: 20%					
			5% Annual		
			Income	*Consume*	*Save*
CRT	$1,000,000		**$50,000**	*$40,000*	*$10,000*
Income tax	-200,000		*Income tax >>>*		*-$2,000*
			Net annual investment		***$8,000***
After-tax	**$800,000**				**<50 years?**

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Can a CRT Produce More Family Wealth Than a Ten Year Liquidation?

Yes. It is possible. But usually not likely.

- It can happen with long-term CRUTS (e.g., 40 or 50 years) and beneficiaries who pay high income tax rates
- Outcomes vary with investment returns and tax rates
- A CRT is best for someone with charitable intentions who also wants to benefit family. It should not be foisted on people who have no charitable intent.

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CRUT Can Offer Other Benefits

- A steady income-stream to the child that will last for the child's entire lifetime
- Asset protection provisions can be included in the CRT in the event of a divorce or other financial challenge
- Professional asset management is possible with a corporate trustee, which could be particularly helpful for a child who would have likely mismanaged a large lump-sum inheritance

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PLANNING and LEGAL HURDLES

A. Choosing the trustee and the charity
B. Choosing the Best Type of CRT
 - CRAT, CRUT, FLIPCRUT, or NIMCRUT
C. How Long ? Term of Years? For Life?
D. CRT Requirements That Can Pose Challenges
E. Extra Requirements for CRATs
F. Asset protection issues
G. Four-tier system for taxation of beneficiaries [*WIFO*]
H. What do you say if a client or a charity suggest "a charitable gift annuity" instead of a CRT ?

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Choosing the trustee and the charity

Charity

- Stable; likely to exist when CRT ends

Trustee

- Competent to administer CRT
- What is the minimum asset size to justify the costs of administering the trust?
- Some charities are willing to do $100,000 CRT if they are named as the remainder beneficiary
 (but maybe not for a long term of 40 or 50 years)

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Choosing the Best Type of CRT
- CRAT, CRUT, FLIPCRUT, or NIMCRUT -

Charitable Remainder Annuity Trust* ("CRAT")** - A trust that pays a ***fixed dollar amount (at least 5% and no more than 50% of the value of the property contributed to the trust) each year to one or more income beneficiaries for life (or for a fixed term of years -- maximum 20) and on liquidation distributes to a charity.

***Charitable Remainder Unitrust* ("Standard CRUT")** - A trust that pays a ***fixed percentage* (at least 5%** and no more than 50%) of the value of the trust's assets each year (redetermined annually) to one or more income beneficiaries for life (or for a fixed term of years -- maximum 20) and on liquidation distributes to a charity.

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CRT Requirements That Can Pose Challenges

1. Annual payouts between 5% and 50%
2. Minimum 10% charitable deduction
3. Avoid multiple donors to a single CRT
4. Private foundation self-dealing rules apply to CRTs
5. Problematic assets (partnership interests, debt-encumbered, etc)
6. Was trust actually administered in accordance with its terms

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Minimum 10% charitable deduction

- The value of the charity's remainder interest of a CRT must be at least 10 percent of the initial net fair market value of all property placed in the trust
- [*computed using the Section 7520 discount rates in effect at the time of contribution.*]
- If a contribution is made to a trust that fails the 10 percent requirement, the trust will not qualify as a tax-exempt CRT.

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Minimum 10% charitable deduction

Oversimplified, there are two ways that the present value of a charity's remainder interest in a CRT can be less than 10 percent of the value of the property contributed to the trust.

- **The first is if the stated payout rate is too high** (e.g., "for the next 20 years, distribute to my child 30% of the trust's assets each year").
- The solution is to lower the CRT's payout rate, but it cannot be lowered below 5%.

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Minimum 10% charitable deduction

The second way is if the projected term of the trust is too long.

- The 10 percent requirement limits the projected term of a CRUT to a maximum of roughly 55 years.
- For example, in 2022 if there was only one beneficiary of a CRUT, then the 10 percent test was met only if the beneficiary was at least age **27**. If there were two beneficiaries who were the same age (e.g., husband and wife), then each had to be at least age **39**.

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Minimum 10% charitable deduction

What can an estate planner do if the beneficiaries are so young that a CRT fails the 10 percent test?

- One strategy is to create multiple CRTs. For example, if a client has three children who are triplets and each is age 27, there could be three CRTs (one per child) rather than a single CRT.
- Another option is to have a CRT for a term of years.

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Term-of-Years CRT:

How much extra benefit does a term-of-years CRT offer?
- Maximum life of a term-of-years CRT: 20 years
- An inherited IRA offers 10 years of tax deferral
- So how much extra benefit does a 20-year CRT offer?

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Term-of-Years CRT:

How much extra benefit does a term-of-years CRT offer?

CRAT
- 2021 interest rates so low, maximum term = 19 years!
- If $1,000,000 is deposited in a 5% CRAT, beneficiary would receive $950,000 over 19 years (19 x $50,000)
- Why not just name the individual as the beneficiary of the IRA and permit $1,000,000 (plus investment income) to be distributed to the beneficiary over 10 years?
- If want to leave dollars to charity, name the charity as a beneficiary of fraction of IRA rather than name a CRAT

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Term-of-Years CRT:

How much extra benefit does a term-of-years CRT offer?

CRUT with high payout? For example, 11%/year?

If the CRUT earned 7%/year:
- Each year, the assets in the CRUT would decline by 4%
- Each year's distribution would decline by 4%
- With a $1M IRA, the CRUT beneficiary would receive less ($1,540,000) over *20 years*, than a *10 year* liquidation of an IRA with annual distributions of $70,000 ($1,700,000)

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Four-tier system for distributions to beneficiaries of a CRT [“WIFO”]

“WIFO”
- “Worst in, first out”
- The worst income that goes *into* the CRT, is the first income that is distributed to the CRT beneficiaries

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Four-tier system for distributions to beneficiaries [“WIFO”]

(1) First, as amounts of income (other than capital gains) to the extent of such income for that year and undistributed income of the trust for all prior years;

(2) Second, as a capital gain to the extent of the capital gain for the year and the undistributed capital gain of the trust for all prior years;

(3) Third, as other income (such as tax-exempt municipal bond interest) to the extent of such income for the year and such undistributed income of the trust for all prior years; and

(4) Fourth, as a distribution of trust corpus.

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Four-tier system for distributions to beneficiaries [“WIFO”]

Example: in a trust’s first year, there is $5,000 of taxable interest and $5,000 of tax-exempt interest. Then $6,000 is distributed to the beneficiary.

Taxation of beneficiary:

	Normal Trust	CRT .
Taxable interest	$ 3,000	$ 5,000
Tax-exempt int	$ 3,000	$ 1,000

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Theory: Tax advantage of income tax deferral !

Move IRD tax-free after death from one tax exempt trust (e.g., the IRA) to another tax-exempt trust (the CRT)

It can be done! PLR 199901023

- no taxable income to beneficiaries until they receive distributions from CRT
- ***IRD is "Tier One" income in the CRT***
- The beneficiary is unlikely to receive any long-term capital gain income or tax-exempt interest for at least 15 or 20 years.

94

What happens when retirement assets were included in an estate that was subject to the federal (or a state) estate tax?

The beneficiary of an IRA can claim an *income* tax deduction for the federal estate tax attributable to the IRD, in the year included in income

The Section 691(c) income tax deduction applies only to the federal estate tax (nothing for state estate taxes)

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Income tax deduction to beneficiary who inherits IRD for *federal* estate tax paid

Example:

\$ 100,000 distributed to a beneficiary from an IRA

\$ 40,000 of estate tax was paid by probate estate

- Beneficiary reports \$100,000 income (IRD)
- Beneficiary claims \$40,000 income tax deduction (itemized deduction on Schedule A – Sec. 691(c))
- Net taxable income to beneficiary: **\$60,000**

(Beneficiary has \$100k of cash, but only paid income tax on \$60k)

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What happens to the 691(c) deduction when IRD is paid to a CRT?

If estate tax was paid, that is "Tier Four" corpus

Example: - $100,000 IRA distributed to a CRT ;

$ 40,000 of estate tax was paid by probate estate*

** - actually, only $36,000 of estate tax would be attributable to the IRD if the estate claimed the minimum 10% charitable deduction, but this example will use $40,000 to illustrate the legal principle with simpler numbers*

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What happens to the 691(c) deduction when IRD is paid to a CRT?

If estate tax was paid, that is "Tier Four" corpus

Example: - $100,000 IRA distributed to a CRT ;

$ 40,000 of estate tax was paid by probate estate

In PLR 199901023, the Service concluded:

The deduction provided by section 691(c)(1)(A) reduces the amount of IRD that Trust includes in its first tier ordinary income. Therefore, <u>the amount of first tier ordinary income from the IRD is the net of the IRD</u> under section 691(a)(1)(B) less the deduction under section 691(c)(1)(A). The section 691(c)(1)(A) deduction is not directly made available to the income beneficiaries under section 664(b).

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What happens to the 691(c) deduction when IRD is paid to a CRT?

If estate tax was paid, that is "Tier Four" corpus

Example: - $100,000 IRA distributed to a CRT ;

$ 40,000 of estate tax was paid by probate estate

- Tier One: $60,000
- Tier Four: $40,000

[CRT distributions are "WIFO"

- the "worst income in is the first income out"]

[Beneficiary gets no tax benefit unless trust shrinks to $40,000 or less]

99

What happens to the 691(c) deduction when IRD is paid to a CRT?

If estate tax was paid, that is "Tier Four" corpus

Example: - $100,000 IRA distributed to a CRT ;

$ 40,000 of estate tax was paid by probate estate

- Tier One: $60,000
- Tier Four: $40,000

Beneficiary gets no tax benefit unless trust shrinks to $40,000 or less
SIMPLE SOLUTION:
**** leave 10% of IRA outright to charity;***
**** leave 90% to beneficiary so beneficiary can get 691(c) deduction***

100

CAN A CRT
STRETCH AN INHERITED IRA?

- Situations that produce the best results for family
  - Combination of a long-term CRT (between 30 and 55 years) and high income tax rates on IRD
- Obstacles and solutions
  - 10% charitable deduction with young beneficiaries
  - Term-of-years CRT won't get much deferral
  - Problem when federal estate tax was paid (WIFO)

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Retirement Accounts
Challenges with Second Marriages

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RETIREMENT PLANS SUBJECT TO THE LAW

- **Section 401(a)** –
  Employer pension, profit sharing and stock bonus plans [*incl. 401(k)*]
- **Section 408 – IRAs**

- Section 403(b) - School and charity employers
- Section 457(b) plans - Government and tax-exempt employers

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WHAT THE QRPs HAVE IN COMMON

- 1. Defer income taxation
- 2. 10% penalty - on most taxable distributions received before age 59 1/2
- 3. RMDs - 50% penalty for failure
- 4. Taxation – ordinary income; no 3.8%

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DIFFERENCES AMONG THE RETIREMENT PLANS

Section 401(a) - Employer pension, profit sharing and stock bonus plans [*incl. 401(k)*]

- Your employer has your money
- Congress: you need protections from business failures; from creditors of your employer; from your own creditors
- ERISA

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DIFFERENCES AMONG THE RETIREMENT PLANS

Section 408 – IRAs
- You select trustee / custodian of your IRA with a regulated financial institution
- There is no need to impose the many complicated ERISA laws to IRAs

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DIFFERENCES AMONG THE RETIREMENT PLANS

Bottom Line:
- Your rights to your **401(k)** account are governed almost exclusively by **federal law**
- Your rights to your **IRA** are governed primarily by **your state's law**

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DIFFERENCES AMONG THE RETIREMENT PLANS

Example:

Your right to get money while employed
- **401(k):** Generally, no right to money until terminate employment. *Possible exceptions:*
  1. loan 2. hardship distribution 3. Age 59 1/2
- **IRA :** No law restricts access to money.

(if under 59 ½, may have to pay IRS 10% penalty)

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DIFFERENCES AMONG THE RETIREMENT PLANS

How accounts are split & taxed at divorce

- **401(k): Need a QDRO**

"Qualified Domestic Relations Order" §414(p)

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§401(a)(13) - Assignment and alienation.

(A) In general. A trust shall not constitute a qualified trust under this section unless the plan of which such trust is a part provides that benefits provided under the plan **may not be assigned or alienated**.

(B) Special rules for domestic relations orders. Subparagraph (A) *shall* apply to the creation, assignment, or recognition of a right to any benefit payable with respect to a participant pursuant to a domestic relations order, ***except that subparagraph (A) shall not apply if the order is determined to be a qualified domestic relations order.***

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DIFFERENCES AMONG THE RETIREMENT PLANS

How accounts are split & taxed at divorce

- **401(k): Need a QDRO**

"Qualified Domestic Relations Order" §414(p)

- **IRA : Simply divide IRA between spouses**

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No QDRO for *IRA* in Divorce

§408(d)(6) Transfer of account incident to divorce
The transfer of an individual's interest in an individual retirement account or an individual retirement annuity to his spouse or former spouse under a divorce or separation instrument …**is not to be considered a taxable transfer made by such individual** notwithstanding any other provision of this subtitle, **and such interest at the time of the transfer is to be treated as an individual retirement account of such spouse, and not of such individual. Thereafter such account or annuity for purposes of this subtitle is to be treated as maintained for the benefit of such spouse.**

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DIFFERENCES AMONG THE RETIREMENT PLANS

How accounts are split & taxed at divorce

- **401(k): Need a QDRO**

"Qualified Domestic Relations Order" §414(p)

- **IRA : Simply divide IRA between spouses**

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§72(t) – Additional 10% tax

(t) 10-percent additional tax on early distributions from qualified retirement plans.
(1) Imposition of additional tax. If any taxpayer receives any amount from a qualified retirement plan (as defined in section 4974(c)), the taxpayer's tax under this chapter for the taxable year in which such amount is received shall be increased by an amount equal to 10 percent of the portion of such amount which is includible in gross income.
(2) Subsection not to apply to certain distributions. Except as provided in paragraphs (3) and (4), *paragraph (1) shall not apply to any of the following distributions:*
(A) In general. Distributions which are--
(i) made on or after the date on which the employee attains *age 59 1/2* ,
(ii) made to a beneficiary (or to the estate of the employee) on or ***after the death of the employee***.

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§72(t) – Additional 10% tax

(t) 10-percent additional tax on early distributions from qualified retirement plans.

(2) Subsection not to apply to certain distributions. Except as provided in paragraphs (3) and (4), paragraph (1) shall not apply to any of the following distributions:
(A) In general. Distributions which are--
(i) made on or after the date on which the employee attains *age 59 1/2* ,

(C) Payments to alternate payees pursuant to qualified domestic relations orders. Any distribution to an alternate payee pursuant to a qualified domestic relations order (within the meaning of section 414(p)(1)).

A QDRO is only for a §401(a) plan (profit sharing, 401(k) etc)

A 10% penalty <u>does</u> apply to a distribution received from an IRA that was split after a divorce, if the recipient is under age 59 ½.

Why? Because IRAs (§408) are not divided pursuant to a §414(p) QDRO

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DIFFERENCES AMONG THE RETIREMENT PLANS

How accounts are split & taxed at divorce

- **401(k): Need a QDRO**

**** Distributions to ex-spouse are taxable income***

**** No 10% penalty for QDRO distribution, if under 59 ½***

- **IRA : Simply divide IRA between spouses**

**** Distributions to ex-spouse are taxable income***

**** <u>Yes</u> 10% penalty if recipient is under age 59 ½***

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MARRIED COUPLES: PLANNING WITH RETIREMENT ASSETS

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MARRIED COUPLES: RETIREMENT ASSETS

Tax Planning:
-- Rollovers ?   -- Funding Trusts ?
-- Second Marriages ?
Legal Rights
-- 401(k) plans: federal law
-- IRAs: state laws

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MARRIED COUPLES:
RETIREMENT ASSETS

Surviving spouse has an option that no other beneficiary has:

a ***rollover*** of deceased spouse's retirement assets to her or his own new IRA

(creditor protection, too!)

Other beneficiaries only option: ***an inherited IRA*** ***, usually liquidated within ten years.***

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MARRIED COUPLES: RETIREMENT ASSETS

Should the estate plan provide:

-- a ***rollover*** of deceased spouse's retirement assets to a new IRA?

-- or --

-- the deceased spouse's retirement assets are payable to a ***trust for the surviving spouse?***

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MANDATORY DISTRIBUTIONS
[Assume inherit IRA at age 80 and die at 94]

D. John Mustard owned three IRAs when he died this year at age 91. His surviving spouse, Honey, turned age 80 the year after his death. Each IRA had a different beneficiary:

- An accumulation trust for Honey, remainder to his children from his first marriage
- A conduit trust for Honey, remainder to his children from his first marriage
- Honey was the sole beneficiary (rollover is possible)

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MANDATORY DISTRIBUTIONS
[Assume inherit IRA at age 80 and die at 94]

AGE	ROLL - OVER	Accumulation Trust	Conduit Trust .
81	5.19%	9.52%	9.52%
85	6.25%	15.38 %	12.35%
90	8.26%	100.00%	17.54%
91	8.77%	empty	18.87%
92	9.26%	empty	20.41%

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IRAs in SECOND MARRIAGES

SURVIVING SPOUSE ROLLOVER?

- The surviving spouse sets up a new IRA in her/his own name
- Then the surviving spouse selects the beneficiaries upon death
- What assurance that a child from the deceased spouse's prior marriage will be named as a beneficiary?

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IRAs in SECOND MARRIAGES

- All IRAs to spouse? Buy some life insurance for children?
- Divide IRAs? Some to spouse; some to children from prior marriage
  -- caution: 401(k) & ERISA plans:
  100% to spouse, unless executes waiver

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RETIREMENT ASSETS IN MARRIAGE

Legal Rights

-- 401(k) plans: federal law

-- IRAs: state laws

I. What are the rights of a surviving spouse to retirement assets when someone other than that spouse is named as the beneficiary at death?

(e.g., children from a prior marriage)

II. Divorce: What happens if the couple has divorced, but at death the ex-spouse is still named as the beneficiary of the retirement account, and there are children from a prior marriage?

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MARRIED COUPLES: 401(a) RETIREMENT ASSETS

Legal Rights: Regardless of who a plan participant named as a beneficiary of a 401(a) account, the surviving spouse is entitled to 100% of the assets in the account ***unless*** that spouse executed a waiver. By comparison, IRAs are generally subject to state laws, including general divorce and community property laws.

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MARRIED COUPLES:
401(a) RETIREMENT ASSETS

A Waiver:

A spouse may waive the privilege to receive the entire account balance by executing a qualified waiver. Such a waiver is also required for other transactions that might reduce a surviving spouse's benefit at death, such as a rollover from a QRP to an IRA.

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MARRIED COUPLES:
401(a) RETIREMENT ASSETS

A Waiver:

- Prenuptial agreements usually ineffective
- The waiver must be signed <u>while married</u>; must acknowledge the effect of the waiver; and must be witnessed by a plan representative or by a notary public

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IRAs in SECOND MARRIAGES

-- 401(k) versus IRA --

Divorce? Then die? And the will or a life insurance policy never changed (still names former spouse as beneficiary)?

- State law in most states: Then the former spouse will not receive under the will, unless the decedent reaffirmed intent that the former spouse should inherit.

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IRAs in SECOND MARRIAGES

-- 401(k) versus IRA --

Facts: Man dies with ex-spouse still named as beneficiary of retirement account and company group-term life insurance. There are children from a prior marriage.

- U.S. Supreme Court: ERISA pre-empts state law. Ex-spouse gets 100% since she is named as beneficiary. *Egglehoff v. Eggelhoff*
- **IRAs?** Probably follow state laws

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IRAs in SECOND MARRIAGES

Facts: Man dies with ex-spouse still named as beneficiary of company retirement account. There are children from a prior marriage.

- **Ex-spouse waived rights in agreement**
- U.S. Supreme Court: ERISA pre-empts state law. Ex-spouse gets 100% since she is named as beneficiary. *Kennedy vs. DuPont (2009)*
- After ex-spouse receives money, estate can sue in state court to recover from ex-spouse
- *Gelschus v. Hogen*, 47 F.4th 679 (8th Cir. Aug. 29, 2022); *Estate of Kensinger v. URL Pharma, Inc.*, 674 F.3d 131, 132-33 (3d Cir. 2012); *Andochick v. Byrd*, 709 F.3d 296, 300 (4th Cir. 2013); *Martinez Olson v. Estate of Olson*, Florida 3rd Dist Court of Appeal (2021)

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IRAs in SECOND MARRIAGES

- All IRAs to spouse? Buy some life insurance for children?
- Divide IRAs? Some to spouse; some to children from prior marriage
- IRAs to a 2-generation charitable remainder trust ?

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2-GENERATION CHARITABLE REMAINDER TRUST

- Typically pays 5% to elderly surviving spouse for life, then 5% to children for life, then liquidates to charity
- Like an IRA, a CRT is exempt from income tax
- Can be like ***a credit-shelter trust for IRD assets*** *[no estate tax marital deduction]*

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2-GENERATION CHARITABLE REMAINDER TRUST

- Can be a solution for ***second marriages*** when estate is top-heavy with retirement assets. Example:

-- Half of IRA to surviving spouse
-- Other half of IRA to a CRT for 2nd spouse and children from 1st marriage

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2-GENERATION CHARITABLE REMAINDER TRUST

TECHNICAL REQUIREMENTS

- Minimum 10% charitable deduction
  -- all children should be over age 30
- CRUT – minimum 5% annual distrib
- No estate tax *marital* deduction
- Charitable intent !

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MANDATORY DISTRIBUTIONS
[Assume inherit IRA at age 80 and die at 94]

AGE	Own IRA	Accumulation Trust	Conduit Trust	C R T
81	5.19%	9.52%	9.52%	5.00%
85	6.25%	15.38 %	12.35%	5.00%
90	8.26%	100.00%	17.54%	5.00%
91	8.77%	empty	18.87%	5.00%
92	9.26%	empty	20.41%	5.00%

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IRAs in SECOND MARRIAGES

- All IRAs to spouse? Buy some life insurance for children?
- Divide IRAs? Some to spouse; some to children
- IRAs to a 2-generation charitable remainder trust ?
- What about the grandchildren?
  (Trust assets go to charity upon death of last child)
- Solution: Life insurance on lives of the children, to benefit grandchildren

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Who Gets Tax Benefits from Charitable Gifts?

- Donors who itemize tax deductions
  (who don't take the "standard deduction")

Impact of 2017 tax changes

- Number of taxpayers who deducted charitable gifts fell from 33 million tax returns in 2017 to just 12 million tax returns in 2018.

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WHAT TO DO ?
Tax Saving Strategies for Charitable Gifts

- Don't forget the 11% who itemize their tax deductions
- "Bunching" charitable gifts every few years
  -- donor advised funds have become more popular
- Most donors over age 70 ½ should make *ALL* of their charitable gifts from their IRAs:
  "Qualified Charitable Distributions" (QCDs)

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"Bunching" Gifts

- Example: Married donors contribute $10,000 per year to charities.
  - But with $10,000 SALT limit, their itemized deductions are only $20,000.
  - So they take the $25,000 standard deduction instead
  - They get no tax benefit from their charitable gifts
- BUNCH gifts: Contribute $40,000 to a DAF.
  - They can itemize this year. Tax savings from gifts.
  - The DAF distributes $10,000 annually over the next four years to their favorite charities

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PHILANTHROPIC CHOICE OF CHARITABLE ENTITY

- **DONOR ADVISED FUND**
  -- a fund or account owned by a sponsoring public charity where the donor (or person appointed by the donor) can recommend grants <u>or</u> investments

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PHILANTHROPIC CHOICE OF CHARITABLE ENTITY

- **DONOR ADVISED FUND**

-- lower administrative costs

-- grants to any public charity

-- very popular: grants from donor advised funds already exceed 50% of grants made from private foundations

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Who Offers Donor Advised Funds?

- Traditionally – Local Community Foundations
  - *The Omaha Community Foundation*
  - *The Jewish Federation of Omaha Foundation*
- Since 1993, "National DAFs" Associated With Financial Establishments
  - *Fidelity, Schwab, Vanguard, Goldman Sachs, etc.*
- And, national charities, colleges and universities,
  - *The National Christian Foundation*
  - *Harvard University*

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Donor Advised Funds

2021 Donor-Advised Fund Report

National Philanthropic Trust

- 1,005,099 – Number of DAFs in 2020
- $160 billion – assets held by DAFs
- $ 48 billion – contributions to DAFs
- $ 35 billion – grants paid by DAFs

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Growth in Number of Donor Advised Funds

Year	Number of DAFs
2016	290,111
2017	469,749
2018	732,128
2019	864,197
2020	1,005,099

Over 70% of the nation's DAFs are less than five years old

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MAKE CHARITABLE GIFTS OF APPRECIATED STOCK

#1 -DONOR's DOUBLE-TAX SAVINGS

	Sell $100,000 -cash gift	Sell $90,000 -stock gift
Gain on the sale	$100,000	$90,000
-Charitable Dedn	- 10,000	- 10,000
= Income	$90,000	**$80,000**
Cash on hand	$90,000	**$90,000**

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MAKE CHARITABLE GIFTS OF APPRECIATED STOCK

#1 -DONOR's DOUBLE-TAX SAVINGS

- Charitable Income Tax Deduction for the Full Appreciated Value of the Stock
- Never Pay Income Tax on the Growth of the Value of the Stock
- **#2 -CHARITY NOT PAY TAX WHEN IT SELLS STOCK** (Charity is tax-exempt)

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MAKE CHARITABLE GIFTS
OF APPRECIATED STOCK

What about investment assets that have fallen in value?

-- Don't donate to charity

-- Sell and take tax loss on sale

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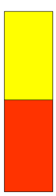
DOUBLE BENEFIT FROM GIFT OF APPRECIATED
L.T.C.G. PROPERTY



<< AVOID LONG-TERM CAPITAL GAIN TAX

<< CHARITABLE INCOME TAX DEDUCTION

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FUTURE INCOME TAX RATES

Highest tax rates	**2022**
• Investment income	**40.8%**
• LT Capital Gains	**23.8%**

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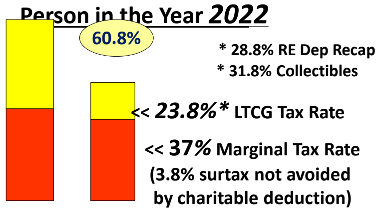
$ Benefits   Max Federal Taxes Saved

Person in the Year *2022*



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MAKE CHARITABLE GIFTS
OF APPRECIATED STOCK

In theory, you should make *all* of your gifts with appreciated stock.

But is that really doable?

Could you make several $100 charitable gifts by giving those several charities each just 2 shares of stock that is trading at $50?

Is that practical in the real world?

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MAKE CHARITABLE GIFTS
OF APPRECIATED STOCK

DONOR ADVISED FUNDS

Administrative Convenience

- **split large gift to many charities**
- **can establish fast! Compare private foundation**
- **anonymous gifts possible with DAFs**
- **one receipt from DAF/PF instead of many CWAs from many charities**

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Tax Court: No Taxable Gain to Donor When Transfer Stock to DAF

Taxpayer donated stock of a closely-held business to a donor advised fund at a national DAF administrator.

- The charity had a stated policy that it sold donated property shortly after receipt to reduce market risk.
- The IRS argued that such a policy meant that the donor should be taxed on the gain as if the donor had personally sold the stock.
- The Tax Court concluded in SUMMARY JUDGEMENT that the taxpayer is NOT taxed on gain from charity's sale
- *Jon Dickinson v. Commissioner*, T.C. Memo. 2020-128 (Sept 3, 2020)

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AMOUNT OF TAX DEDUCTION FOR PUBLICLY TRADED STOCK

Average of high-low for the day

XYZ Stock given to charity at 12:30 pm

- $ 98 – price of stock at 12:30 pm
- $ 90 – lowest price of stock that day
- $100 - highest price of stock that day
- $ 93 – price when stock market closed

Charitable income tax deduction?

$95 – average of high-low for the day

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MAKE CHARITABLE GIFTS OF APPRECIATED STOCK

- In theory, you should make *all* of your gifts with appreciated stock.
- *Exception:* most donors over age 70 ½ should make *ALL* of their charitable gifts from their IRAs: *"Qualified Charitable Distribution" (QCD)*

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LIFETIME CHARITABLE GIFTS FROM IRAs

General Rule:

- EVERY distribution from a person's retirement account (while that person is alive) will be taxable income to the owner of the account, even if the check is written to someone other than the owner

EXCEPTION:

- "Qualified Charitable Distributions" – Over age 70 ½ (a/k/a "QCDs" – "Charitable IRA Rollover")

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Qualified Charitable Distribution -- Lifetime Gifts from IRAs –

- Eligible Donors:
  - -- Won't report charitable gifts from IRAs as taxable income
  - -- Not entitled to charitable income tax deduction

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Qualified Charitable Distribution -- Lifetime Gifts from IRAs –

- Eligible Donors:
  - -- Won't report charitable gifts from IRAs as taxable income
  - -- Not entitled to charitable income tax deduction

❑ Example: Donor, age 75, who has a $10,000 RMD from IRA, says:

- ❑"Issue a check to a charity for $4,000"
- ❑"Issue a check to me for $6,000"

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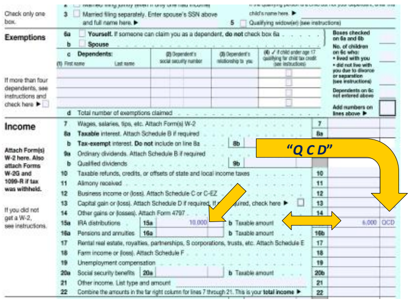

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Qualified Charitable Distribution
-- Lifetime Gifts from IRAs --

- IRA owner must be over age 70 ½
- Maximum: $100,000 per year
- Yes! Charitable gift satisfies required minimum distribution requirement from IRA!

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WHO WINS?

- Donors who do not itemize tax deductions (“standard deduction”)
- Donors who live in states where the state income tax laws do not permit deductions for charitable contributions (Ohio, Indiana, etc)

162

WHO WINS ?

- Donors who incur taxes as their income increases
  -- social security benefits taxable
  -- Medicare "B" premiums
  -- 3.8% health tax if AGI>$200,000
- The heirs
  -- inherited stock gets step-up tax basis
  -- inherited IRAs are taxable income

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LEGAL REQUIREMENTS

- Over age 70 ½
- IRA (only) – <u>not</u> 403(b), 401(k), etc.
- "Directly" from the IRA to charity
  -- "IRA checkbooks" are OK

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LEGAL REQUIREMENTS

- ELIGIBLE CHARITY – Public charity or private *operating* foundation
  -- however, a PF, donor advised fund or supporting org is <u>not</u> eligible
- Must qualify for full charitable deduction – no dinners; no CGAs

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LEGAL REQUIREMENTS

- Taxable part of IRA distributions (only)
  -- tax-free distributions protected
- Donor must have letter from charity that donor received no goods or services in exchange for the gift

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TECHNICAL ISSUES

- Yes! Charitable IRA gifts can satisfy legally binding pledges!
- Joint return? Up to $200,000
- No withholding taxes
- Beneficiary of an inherited IRA <u>who is over age 70 ½</u> can make charitable gifts of required distributions

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Want to make charitable gifts from your IRA ("QCD")? *Then NEVER make a tax-deductible contribution to your IRA after attaining age 70 ½*

SECURE Act: Beginning in the year 2020, employed taxpayers over age 70 ½ are permitted to make tax-deductible contributions to a traditional IRA (e.g, up to $7,000 per year)

HOWEVER: If a person ever makes a tax-deductible contribution to an IRA after age 70 ½, then the amount of the qualified charitable distribution from an IRA that can be excluded from taxable income is reduced by that amount.

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Want to make charitable gifts from your IRA ("QCD")?
Then NEVER make a tax-deductible contribution to your IRA after attaining age 70 ½

New last sentence added to end of Sec 408(d)(8)(A):

The amount of distributions not includible in gross income by reason of the preceding sentence for a taxable year (determined without regard to this sentence) shall be reduced (but not below zero) by an amount equal to the excess of—

- ***(i) the aggregate amount of deductions allowed to the taxpayer under section 219 for <u>all</u> taxable years ending on or after the date the taxpayer attains age 70 ½, over***
- ***(ii) the aggregate amount of reductions under this sentence for <u>all</u> taxable years preceding the current taxable year.***

169

Want to make charitable gifts from your IRA ("QCD")?
Then NEVER make a tax-deductible contribution to your IRA after attaining age 70 ½

LEGISLATIVE INTENT

- To get a tax benefit from a charitable gift, a taxpayer must generally itemize deductions (state taxes, mortgage interest, etc)
- Only 11% of tax returns itemized deductions in 2018
- A working senior could (a) contribute $7,000 to an IRA and then (b) distribute $7,000 that same year to charities, and indirectly deduct charitable gifts via IRA contributions

ADMINISTRATIVE and BOOKEEPING HEADACHES

- People in their 80s and 90s will need to keep all tax records after age 70 ½ and then make cumulative computations

170

Want to make charitable gifts from your IRA ("QCD")?
Then NEVER make a tax-deductible contribution to your IRA after attaining age 70 ½

EXAMPLE

- I. Work's RMD both for this year and next year is $5,000
- She donates each year's RMD to charity; would be QCD
- She is employed. This year she deducts $7,000 for IRA. Next year she does not deduct any IRA contribution
- How much can she EXCLUDE from income for QCD?

Year	Donate	Exclude	Taxable
This year	$5,000	-0-	$5,000*
Next year	$5,000	$3,000	$2,000*

* Taxpayer can claim an *itemized* charitable deduction

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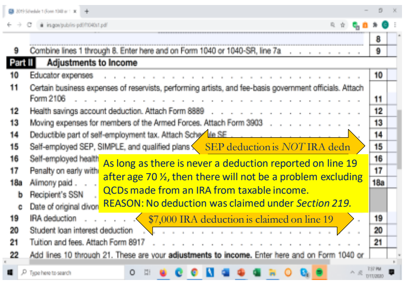
Only the $7,000 *IRA* deduction is a problem for QCDs



172

Want to make charitable gifts from your IRA ("QCD")?
Then NEVER make a tax-deductible contribution to your IRA after attaining age 70 ½

STRATEGIES

- If ever want to make a QCD, don't contribute after age 70 ½
- Working seniors can contribute to plan at work (401(k), etc.)
- Working seniors can contribute to a Roth IRA (if income under $144k ($214k married))
- Self-employed? Contribute to an SEP-IRA

  (but <u>don't</u> make a QCD from the SEP that <u>same year</u>)

Footnote: Employed upper-income taxpayers can't even make tax-deductible contributions to an IRA if there is a plan at work (e.g., 401(k)). No tax deduction is permitted in year 2022 if AGI is over $78,000 ($129,0000 on married joint returns). IRS Tax Tip 2021-170.

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RETIREMENT ACCOUNTS

REQUIRED DISTRIBUTION RULES
AFTER ENACTMENT OF THE SECURE ACT

TABLES AND COMPUTATIONS

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A. OBJECTIVES - Keep the largest amount in an IRA or QRP, so you can earn investment income on the deferred income taxes in the account. EXAMPLE:

	Principal	10% Yield		5% Yield	
Amount in IRA	$100,000	10%	$ 10,000	5%	$ 5,000
Income Tax on Distribution (40%)	40,000				
Amount Left to Invest	$ 60,000	10%	$ 6,000	5%	$ 3,000

In order to force QRP and IRA accounts to be used to provide retirement income, Congress enacted two significant penalties. First, there is a 10% penalty tax for most distributions before age 59 ½. Section 72(t). Second, there is a 50% penalty tax imposed on the account owner for not receiving the required minimum distribution ("RMD"). Sec. 4974; Reg. Sec. 54.4974-2. The penalty is imposed during one's lifetime after attaining the age of 72 or retiring, whichever occurs later. The 50% penalty tax also applies after the account owner's death to beneficiaries who fail to receive the post-death minimum amounts.

B. REQUIRED LIFETIME DISTRIBUTIONS AFTER AGE 72 [previously age 70 ½]

GENERAL RULES – Unless you are married to someone who is more than ten years younger than you, there is one -- and only one -- table of numbers that tells you the portion of your IRA, 403(b) plan or qualified retirement plan that must be distributed to you each year after you attain the age of 72. The only exception to this table is if (1) you are married to a person who is more than ten years younger than you and (2) she or he is the only beneficiary on the account. In that case the required amounts are even less than the amounts shown in the table. To be exact, the required amounts are based on the joint life expectancy of you and your younger spouse.

– *Year 2022 and later* --UNIFORM LIFETIME DISTRIBUTION TABLE –

Age	*Payout*						
70 ½	-0-%	80	4.95%	90	8.27%	100	15.63%
71	-0-%	81	5.19%	91	8.78%	101	16.95%
72	3.67%	82	5.44%	92	9.26%	102	17.86%
73	3.79%	83	5.69%	93	9.91%	103	19.24%
74	3.93%	84	5.96%	94	10.53%	104	20.41%
75	4.07%	85	6.25%	95	11.24%	105	21.74%
76	4.22%	86	6.58%	96	12.05%	106	23.26%
77	4.39%	87	6.95%	97	12.83%	107	24.39%
78	4.57%	88	7.36%	98	13.70%	108	25.65%
79	4.77%	89	7.76%	99	14.71%	109	27.03%

[Table computed from Table A-2 of Reg. Sec. 1.401(a)(9)-9 (2002) -- (rounded up)]

TWO SIMPLE STEPS:
Step 1: Find out the value of your investments in your retirement plan account on the last day of the preceding year. For example, on New Years Day -- look at the closing stock prices for December 31.
Step 2: Multiply the value of your investments by the percentage in the table that is next to the age that you will be at the end of this year. This is the minimum amount that you must receive this year to avoid a 50% penalty.

> Example: Ann T. Emm had $100,000 in her only IRA at the beginning of the year. She will be age 80 at the end of this year. In the year 2021, she must receive at least $5,350 during the year to avoid a 50% penalty (5.35% times $100,000). If she had attained age 80 in the year 2022, she would only need to receive at least $4,950 during the year to avoid a 50% penalty (4.95% times $100,000)

C. MAXIMUM YEARS FOR PAYOUTS AFTER ACCOUNT OWNER'S DEATH: TEN YEARS, FIVE YEARS, OR A REMAINING LIFE EXPECTANCY

Failure to receive the required minimum distribution ("RMD") for that year from an inherited retirement account triggers a 50% penalty on the shortfall. The maximum time period over which a decedent's account may be liquidated without such a penalty after the year of death is either:

(#1) ten years, if only "designated beneficiaries" ("DBs") (or a "look-through trust" with 100% DBs) are the beneficiaries of the account, § *401(a)(9)(H)(i)*

- If the IRA owner died *before* the required beginning date (i.e., before April 1 of the year that the person would have attained age 73), there is no RMD until the last day of the 10th year.
- If the IRA owner died *after* the required beginning date (i.e., after April 1 of the year that follows the year that the person attained age 72), the 2022 proposed regulations would require an RMD in each of the nine years that follow the IRA owners death, and then full liquidation of the account in the 10th year. *Prop. Reg.* § 1.401(a)(9)-5(d)(1).

(#-2) the remaining life expectancy of an eligible designated beneficiary ("EDB"), based on the EBD's age at the end of the year that follows the account owner's death. An EDB is a beneficiary who is: a surviving spouse, a minor child of the decedent, disabled, chronically ill, or someone who is not more than ten years younger than the decedent (there is an RMD every year), §§ *401(a)(9)(H)(ii), (E)(ii) & B(iii)*

(#3) five years(there is no RMD until the 5th year)**,** if the account owner died before the required beginning date ("RBD") and there is even just one non-DB on the "determination date" (generally, September 30 following the year of death), §§ *401(a)(9)(B)(ii) and (H)(i)("Except in the case of...);Reg.* § 1.401(a)(9)-3 Q&A 4*;* or

(#4) the life expectancy of someone who was the account owner's age (a/k/a a **"ghost life expectancy")** if the account owner died after the RBD and there is even just one non-DB on the "determination date." There will be RMDs in each of those years. §§ *401(a)(9)(B)(i) and (H)(i); Reg.* § 1.401(a)(9)-5 Q&A 5(c)(3)

LIFE EXPECTANCY TABLE - Years 2022 and later

Age	Life Expectancy	Age	Life Expectancy	Age	Life Expectancy	Age	Life Expectancy	Age	Life Expectancy
0	84.5	20	65.0	40	45.7	60	27.1	80	11.2
1	83.7	21	64.0	41	44.7	61	26.2	81	10.5
2	82.7	22	63.0	42	43.8	62	25.3	82	9.9
3	81.7	23	62.0	43	42.8	63	24.5	83	9.2
4	80.8	24	61.1	44	41.8	64	23.6	84	8.6
5	79.8	25	60.1	45	40.9	65	22.8	85	8.1
6	78.8	26	59.1	46	39.9	66	22.0	86	7.5
7	77.8	27	58.2	47	39.0	67	21.2	87	7.0
8	76.8	28	57.2	48	38.0	68	20.4	88	6.6
9	75.8	29	56.2	49	37.1	69	19.5	89	6.1
10	74.8	30	55.3	50	36.1	70	18.7	90	5.7
11	73.8	31	54.3	51	35.2	71	17.9	91	5.3
12	72.8	32	53.4	52	34.3	72	17.1	92	4.9
13	71.9	33	52.4	53	33.1	73	16.3	93	4.6
14	70.9	34	51.4	54	32.4	74	15.6	94	4.2
15	69.9	35	50.5	55	31.5	75	14.8	95	3.9
16	68.9	36	49.6	56	30.6	76	14.0	96	3.7
17	67.9	37	48.6	57	29.7	77	13.3	97	3.4
18	66.9	38	47.6	58	28.8	78	12.6	98	3.2
19	66.0	39	46.6	59	27.9	79	11.9	99	3.0

Table A-1 of Reg. Sec. 1.401(a)(9)-9 ("single life "), required by Reg. Sec. 1.401(a)(9)-5, Q&A 5(a) & 5(c) and Q&A 6.

D. REQUIRED DISTRIBUTIONS AFTER DEATH-- Terminology

Required Beginning Date ("RBD") - The first date that a distribution must be made from an IRA, QRP or 403(b) account to the account owner in order to avoid the 50% penalty tax.[1]

> ***IRAs*:** The RBD for an IRA is April 1 following the calendar year that the IRA account owner attains age 72.[2]
>
> ***QRP or 403(b)***: The RBD for a qualified retirement plan or a tax-sheltered annuity is the *later* of (a) April 1 following the calendar year that the account owner attains age 72 or (b) April 1 following the calendar year that the employee separates from service (e.g., somebody who works past age 73).[3] Individuals who own 5% or more of a business are not eligible for this later RBD: their RBD is April 1 following the calendar year that they attain age 72.

"Beneficiaries" versus "Designated Beneficiary" ("DB") - A beneficiary is any person or entity that is entitled to receive benefits from a QRP or IRA account after the account owner's death. By comparison, a *designated beneficiary* is an *individual* who is entitled to the benefits of the IRA or QRP account upon the death of the employee / participant / IRA owner (hereafter "account owner").[4] Neither a charity nor the decedent's estate will qualify as a DB since neither has a life expectancy. If certain criteria are met, a trust may be the beneficiary of an IRA or QRP and distributions will be based on the beneficiaries of that trust (a "look-through trust").

"Eligible Designated Beneficiary" ("EDB") - An EDB qualifies for an exception to the general ten liquidation rule. An EDB may receive distributions over his or her the remaining life expectancy of an eligible designated beneficiary ("EDB"), based on the EBD's age at the end of the year that follows the account owner's death. An EDB is a beneficiary who is: a surviving spouse, a minor child of the decedent (though upon attaining majority age, the ten year rule applies), disabled, chronically ill, or someone who is not more than ten years younger than the decedent.[5]

Determination Date - The minimum distributions will be computed based only on the beneficiaries who still have an interest on the determination date. That date is September 30 of the calendar year that follows the calendar year of the account owner's death.[6] Example: Sarah died on September 14, 2021, the determination date for her IRA and QRP accounts will be September 30, 2022.

There are basically three ways to eliminate some of the beneficiaries before the determination date: (1) disclaimers, (2) cash-out of a beneficiary and (3) separate accounts for different beneficiaries. If a beneficiary's interest is eliminated between the time that the account owner died and the determination date – for example by a cash out or a disclaimer -- then that beneficiary will not impact the required minimum distributions. PLR 200740018 (July 12, 2007).

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[1] Sec. 4974; Reg. Sec. 54.4974-2, Q&A 1 and 2; Sec. 401(a)(9)(C)(i).

[2] Sec. 408(a)(6); Reg. Sec. 1.408-8 Q&A 3.

[3] Sec. 401(a)(9)(C); Reg. Sec. 1.401(a)(9)-2, Q&A 2.

[4] Sec. 401(a)(9)(E)(i); Reg. Sec. 1.401(a)(9)-4, Q&A 1.

[5] Sec. 401(a)(9)(E)(ii)

[6] Reg. Sec. 1.401(a)(9)-4, Q&A 4.

E. REQUIRED MINIMUM DISTRIBUTIONS FROM IRAs AND QRPs AFTER THE ACCOUNT OWNER'S DEATH, BASED ON THE BENEFICIARIES AS OF THE "DETERMINATION DATE"

BENEFICIARY	DEATH BEFORE RBD	DEATH AFTER RBD
"*No designated beneficiary* (**"DB"**)**"** - if there is even just one non-human beneficiary (e.g., probate estate or a charity)	Five Years *[No RMD until the 5th year*]	Remaining life expectancy of someone who was the *decedent's age* in the year of death ("ghost life expectancy") *[RMDs must be made each year]*
NON-SPOUSE DESIG. BENIF.		
General Rule if all beneficiaries are individuals ("DBs")	Ten Years	- Same: Ten Years - * * An argument can be made that the term can be the "ghost life expectancy," if that is more than ten years
Rollover option?	Not available to anyone but a surviving spouse.**	** - Possible to transfer decedent's account from a company plan (but not from an IRA) to an IRA payable over ten years (or life expectancy of an EDB)
Eligible Designated Beneficiary ("EDB")	Remaining life expectancy of the *EDB*,* fixed as of the year *after* death. Distributions must begin before the end of the year that follows the year of death. *[RMDs must be made each year]*	– Same Rule – * - (if the EDB is older than the deceased, use life expectancy based on the deceased's age)
Beneficiaries include both EDBs and non-EDBs	Unless separate shares are established, generally Ten Years (or Five Years). Special rules benefit accumulation trust for disabled & chronically ill.	Ten Years (or remaining life expectancy of someone who was the *decedent's age*) [unless separate shares; special rules benefit disabled & chronically ill]
SPECIAL RULES		
"Look-through"trust/ "See-through" trust	"Look through" to identity of DBs and EDBs of the trust to determine RMDs.	– Same Rule --
Remainder beneficiary	A remainder beneficiary is counted as a beneficiary of an *accumulation trust*, but not of a *conduit trust*	– Same Rule –

BENEFICIARY	**DEATH BEFORE RBD**	**DEATH AFTER RBD**
SPOUSE IS THE BENEFICIARY		
Rollover Option?	Yes, available	Yes, available
Leave in deceased's account and spouse is the sole beneficiary?		
-- General Rule	**Minimum distributions over the surviving spouse's remaining life expectancy, *gradually extended* each year as the spouse ages.**	**– Same Rule --**
-- IRAs only: elect to treat as own IRA	**Surviving spouse can elect to leave assets in deceased's IRA but treat that IRA like a rollover IRA.**	**– Same Rule --**
-- Decedent died before age 72?	**Can defer first distribution until the year that the deceased spouse would have been age 72.**	**Not applicable**
MULTIPLE DBs; ONE IS THE SPOUSE		
Both spouse and another DB are the beneficiaries	Generally ten years, unless separate shares are established.	– Same Rule --
Both spouse and a charity are beneficiaries	Five Years, unless separate accounts are established for the beneficiaries.	Remaining life expectancy of someone who was the *decedent's age*, unless separate accounts for the beneficiaries.
"Look-through" trust/ "See-through" trust	Generally ten years, since "look through" to identity of the beneficiaries. If payable to a conduit trust, then the remaining life expectancy of the spouse.	– Same Rule --
Remainder beneficiary	A remainder beneficiary is counted as a beneficiary of an *accumulation trust*, but not of a *conduit trust*	– Same Rule –

SURVIVING SPOUSE DISTRIBUTION OPTIONS – AT AGE 80

Example: At age 80, Ms. Widow began receiving distributions from several IRAs, including the IRAs of her older husband and her older sister (each of whom had died in the preceding year at age 91). Although the life expectancy of an 80 year old is 11.2 years (i.e., to age 91), Ms. Widow in fact lived to age 94. Whereas the law requires two IRAs (IRAs C and D) to be empty by age 89 (ten years after the deaths), amounts could still remain in other IRAs at that age. The minimum amounts required to be distributed from each of six IRAs are:

A - ***Her own IRA,*** established with contributions she made during her working career.
B -** ***A rollover IRA, funded after her husband's death with a distribution from his 401(k) plan.
C - ***An inherited IRA (her sister's IRA)***
D - ***Bypass Trust #1 - Her deceased husband's IRA is payable to a standard bypass trust***, treated as a stretch IRA payable to a ***look-through accumulation trust*** (required distributions from an accumulation trust are determined by looking at all beneficiaries of the trust – EBDs and non-EDBs. The same distribution rules apply to a QTIP trust.)
E -** ***Bypass Trust #2 - Her deceased husband's IRA is payable to a similar trust, but the trust requires all retirement plan distributions to be made to Ms. Widow. This provision permits a look-though trust to be treated as a ***conduit trust***
CRT - ***Charitable Remainder Trust*** - After his death, her husband's fourth IRA was distributed in a lump sum to a tax-exempt CRT that will annually distribute 5% of its assets to Ms. Widow for the rest of her life, then to her husband's 50-year old child from his first marriage for the rest of the child's life, and then upon the child's death will be distributed to a charity.

AGE	IRAs A & B	IRAs C & D	IRA E	IRA CRT
80	*>>> The decedent's RMD in year of death*			
81	5.19%	* -0- %	9.53%	5.00%
82	5.44%	* -0- %	10.10%	5.00%
83	5.69%	* -0- %	10.87%	5.00%
84	5.96%	* -0- %	11.63%	5.00%
85	6.25%	* -0- %	12.35%	5.00%
86	6.58%	* -0- %	13.33%	5.00%
87	6.95%	* -0- %	14.29%	5.00%
88	7.36%	* -0- %	15.15%	5.00%
89	7.76%	* -0- %	16.40%	5.00%
90	8.27%	100.00%	17.54%	5.00%
91	8.78%	empty	18.87%	5.00%
92	9.26%	empty	20.41%	5.00%
93	9.90%		21.38%	5.00%
94	10.53%		23.81%	5.00%

Payout "B" (a rollover) is <u>only</u> available to a surviving spouse.
Payout "E" permits a surviving spouse to annually recompute her life expectancy. With a conduit trust, RMDs are computed without considering remainder beneficiaries (unlike an accumulation trust).
** - the 2022 proposed regulations would require a distribution in each of the nine years.*

Legal Authority for Various Payout Rules: **IRA A**: Reg. Sec. 1.401(a)(9)-5, Q&A 4 and Reg. Sec. 1.401(a)(9)-9, Table A-2. **IRA B:** Same, and Secs. 402(c)(9) and 408(d)(3)(C)(ii)(II) permit a surviving spouse to do a rollover. **IRA C:** Secs. 401(a)(9)(H)(i) and (vi), and 408(d)(3)(C). **IRA D:** Reg. Sec. 1.401(a)(9)-5, Q&A 7(c)(3), Example 1, as modified by Sec. 401(a)(9)(H)(i) and (vi). **IRA E:** Reg. Sec. 1.401(a)(9)-5, Q&A 7(c)(3), Example 2, reinforced by Secs. 401(a)(9)(H)(E)(ii)(I) and (H)(ii).

Required Payments <u>after Ms. Widow's Death</u>:

IRAs A & B: IRAs A & B will generally be liquidated within ten years after Ms. Widow's death to the beneficiaries that she named. Sec. 409(a)(9)(H)(iii)(2020).

IRA E: Ms. Widow is an *eligible designated beneficiary*, and a conduit trust permits her to recompute her life expectancy and to ignore remainder beneficiaries for RMDs. After Ms. Widow's death, payments from IRA E must generally be completed over ten years. Sec. 409(a)(9)(H)(iii)(2020)**.** (Compare Reg. Sec. 1.401(a)(9)-5, Q&A 5(c)(2) – old law provided that the remaining term was over the life of someone who was her age in the year of her death).

IRA CRT (Exhibit G): The charitable remainder unitrust (CRUT) will commence payments to the next beneficiaries (children) upon the death of the surviving spouse. A CRUT must annually distribute at least 5% of the value of its assets, recalculated annually. With a two generation trust (parent and then child), the parties will likely select the 5% amount to generate the minimum 10% charitable deduction necessary for the trust to qualify as a CRT.

<u>IRS Private Letter Rulings - 2014 - 2022</u>

A surviving spouse can rollover a deceased spouse's retirement account, even when the account is payable to:

A TRUST FOR THE SPOUSE

* PLR 202136004 (14 June 2021) - Roth IRA can be rolled over
* PLR 201944003 (Aug 8, 2019) - payable to revocable joint trust
* PLR 201923002 (March 4, 2019) - payable to trust where spouse is trustee and beneficiary
* PLRs 201934006 & 201935005 - spouse mistakenly listed as contingent beneficiary
* PLR 201844004 (Aug 4, 2018) - payable to spouse's revocable trust
* PLR 201707001 (Nov 8, 2016) - payable to revocable joint trust
* PLR 201632015 (May 10, 2016) - payable to trust - community property state
* PLR 201507040 (Dec 24, 2014)
* PLR 201430029 (Apr 30, 2014) - H's IRA payable to W's revocable trust
* PLR 201430026 (Apr 29, 2014)
* PLR 201423043 (Feb 29, 2014) - Rollover Roth IRAs payable to a marital trust

THE ESTATE, WITH ESTATE POUR-OVER INTO A TRUST FOR THE SPOUSE

* PLR 201736018 (June 9, 2017) - payable to estate; pourover into trust
* PLR 201511036 (Dec 18, 2014) and * PLR 201437029 (June 05, 2014)

THE ESTATE, WHERE THE SPOUSE IS THE SOLE OR RESIDUARY BENEFICIARY OF THE ESTATE

*PLR 202210016 (Dec. 13, 2021)
*PLR 201931006 (7 May 2019) - probate estate was default beneficiary when beneficiary form left blank
* PLR 201451066 (Sep 25, 2014)
* PLR 201445031 (Aug 11, 2014) - spouse is residuary beneficiary of estate
* PLR 201430027 (Apr 30, 2014) - spouse is residuary beneficiary of estate
* PLR 201430020 (May 1, 2014)

COMBINATION OF *FEDERAL* ESTATE AND INCOME TAXES ON INCOME IN RESPECT OF A DECEDENT – (Year 2022). ***State estate & income taxes are extra!***

EXAMPLE: Assume Mother's total taxable estate is $12,000,000 and that all of it will be transferred to her sole heir: Daughter. Assume that the estate will pay the entire estate tax regardless of how Daughter acquired the assets (e.g., joint tenancy, etc.). If $100,000 in an IRA is immediately distributed to Daughter and if Daughter is in a *37% marginal income tax bracket*, then the combined estate and income taxes on the $100,000 of IRA assets would be **$62,200 (62%)**.

Beginning Balance in Retirement Plan			$ 100,000
Minus: Total Estate Tax Paid by the Probate Estate			(40,000)
Minus: Income Tax On Distribution			
Gross Taxable Income		$ 100,000	
Reduced By §691(c) Deduction for *Federal* Estate Tax			
Total Estate Tax	$ 40,000		
State Tax Credit*	Zero		
Deduction for Federal Estate Tax **		(40,000)	
Net Taxable Income		$ 60,000	
Times Income Tax Rate***		x 37%	
Net Income Tax on Income In Respect Of Decedent			(22,200)
NET AFTER-TAX AMOUNT TO DAUGHTER			$ 37,800

* Treas. Reg. Section 1.691(c)-1(a) limits the deduction to *federal* estate tax. The 2001 Tax Act provided that the Section 2011 state tax credit was fully repealed by the year 2007 so there is no state tax adjustment.

** The deduction is an itemized deduction on Schedule A that is claimed on the last line of the form ("other miscellaneous deductions"). It is not subject to the 2%-of-adjusted-gross-income ("AGI") limitation that most miscellaneous deductions had been subject to. Sec. 67(b)(7). Thus, the Section 691(c) deduction can still be claimed in 2020, even though the 2017 Tax Cut & Jobs Act eliminated the ability to deduct most other miscellaneous itemized deductions.

*** Whereas retirement income is exempt from the 3.8% health care surtax, if the source of IRD is income that is subject to the surtax (interest, annuity, rents, etc) then the effective marginal income tax rate would be even higher than 37%. The 3.8% health care surtax applies when an individual's adjusted gross income exceeds $250,000 ($300,000 on a joint return). For a trust or estate, the 37% marginal tax rate (plus the 3.8% health care surtax) applies with taxable income over just $12,500.

Section 401(a)(9) Required distributions.

(A) In general.—A trust shall not constitute a qualified trust under this subsection unless the plan provides that the entire interest of each employee—

(i) will be distributed to such employee not later than the required beginning date, or

(ii) will be distributed, beginning not later than the required beginning date, in accordance with regulations, over the life of such employee or over the lives of such employee and a designated beneficiary (or over a period not extending beyond the life expectancy of such employee or the life expectancy of such employee and a designated beneficiary).

(B) Required distribution where employee dies before entire interest is distributed.—

(i) Where distributions have begun under subparagraph (A)(ii).—A trust shall not constitute a qualified trust under this section unless the plan provides that if—

(I) the distribution of the employee's interest has begun in accordance with subparagraph (A)(ii), and

(II) the employee dies before his entire interest has been distributed to him,

the remaining portion of such interest will be distributed at least as rapidly as under the method of distributions being used under subparagraph (A)(ii) as of the date of his death.

(ii) 5-year rule for other cases.—

A trust shall not constitute a qualified trust under this section unless the plan provides that, if an employee dies before the distribution of the employee's interest has begun in accordance with subparagraph (A)(ii), the entire interest of the employee will be distributed within 5 years after the death of such employee.

(iii) Exception to 5-year rule for certain amounts payable over life of beneficiary.—If—

(I) any portion of the employee's interest is payable to (or for the benefit of) a designated beneficiary,

(II) such portion will be distributed (in accordance with regulations) over the life of such designated beneficiary (or over a period not extending beyond the life expectancy of such beneficiary), and

(III) such distributions begin not later than 1 year after the date of the employee's death or such later date as the Secretary may by regulations prescribe,

for purposes of clause (ii), the portion referred to in subclause (I) shall be treated as distributed on the date on which such distributions begin.

(iv) Special rule for surviving spouse of employee.—If the designated beneficiary referred to in clause (iii)(I) is the surviving spouse of the employee—

(I) the date on which the distributions are required to begin under clause (iii)(III) shall not be earlier than the date on which the employee would have attained age 72, and

(II) if the surviving spouse dies before the distributions to such spouse begin, this subparagraph shall be applied as if the surviving spouse were the employee.

(C) Required beginning date.—For purposes of this paragraph—

(i) In general.—The term "required beginning date" means April 1 of the calendar year following the later of—

(I) the calendar year in which the employee attains age 72, or

(II) the calendar year in which the employee retires.

(ii) Exception.—Subclause (II) of clause (i) shall not apply—

(I) except as provided in section 409(d), in the case of an employee who is a 5-percent owner (as defined in section 416) with respect to the plan year ending in the calendar year in which the employee attains age 72, or

(II) for purposes of section 408(a)(6) or (b)(3).

(iii) Actuarial adjustment.—

In the case of an employee to whom clause (i)(II) applies who retires in a calendar year after the calendar year in which the employee attains age 70½, the employee's accrued benefit shall be actuarially increased to take into account the period after age 70½ in which the employee was not receiving any benefits under the plan.

(iv) Exception for governmental and church plans.—
Clauses (ii) and (iii) shall not apply in the case of a governmental plan or church plan. For purposes of this clause, the term "church plan" means a plan maintained by a church for church employees, and the term "church" means any church (as defined in section 3121(w)(3)(A)) or qualified church-controlled organization (as defined in section 3121(w)(3)(B)).

(D) Life expectancy.—
For purposes of this paragraph, the life expectancy of an employee and the employee's spouse (other than in the case of a life annuity) may be redetermined but not more frequently than annually.

[OLD LAW:] (E) Designated beneficiary.—
For purposes of this paragraph, the term "designated beneficiary" means any individual designated as a beneficiary by the employee.

[NEW LAW Jan 1, 2020:]

(E) DEFINITIONS AND RULES RELATING TO DESIGNATED BENEFICIARIES.—For purposes of this paragraph—

(i) Designated Beneficiary.—The term 'designated beneficiary' means any individual designated as a beneficiary by the employee.

(ii) Eligible Designated Beneficiary.—The term 'eligible designated beneficiary' means, with respect to any employee, any designated beneficiary who is—

(I) the surviving spouse of the employee,

(II) subject to clause (iii), a child of the employee who has not reached majority (within the meaning of subparagraph (F)),

(III) disabled (within the meaning of section 72(m)(7)),

(IV) a chronically ill individual (within the meaning of section 7702B(c)(2), except that the requirements of subparagraph (A)(i) thereof shall only be treated as met if there is a certification that, as of such date, the period of inability described in such subparagraph with respect to the individual is an indefinite one which is reasonably expected to be lengthy in nature), or

(V) an individual not described in any of the preceding subclauses who is not more than 10 years younger than the employee. The determination of whether a designated beneficiary is an eligible designated beneficiary shall be made as of the date of death of the employee.

(iii) Special Rule for Children.—Subject to subparagraph (F), an individual described in clause (ii)(II) shall cease to be an eligible designated beneficiary as of the date the individual reaches majority and any remainder of the portion of the individual's interest to which sub-paragraph (H)(ii) applies shall be distributed within 10 years after such date.

(F) Treatment of payments to children.—
Under regulations prescribed by the Secretary, for purposes of this paragraph, any amount paid to a child shall be treated as if it had been paid to the surviving spouse if such amount will become payable to the surviving spouse upon such child reaching majority (or other designated event permitted under regulations).

(G) Treatment of incidental death benefit distributions.—
For purposes of this title, any distribution required under the incidental death benefit requirements of this subsection shall be treated as a distribution required under this paragraph.

Sub-Paragraph "H" was added by the SECURE Act, effective Jan 1, 2020:

(H) SPECIAL RULES FOR CERTAIN DEFINED CONTRIBUTION PLANS.—In the case of a defined contribution plan, if an employee dies before the distribution of the employee's entire interest—

(i) IN GENERAL.—Except in the case of a beneficiary who is not a designated beneficiary, subparagraph (B)(ii)—

(I) shall be applied by substituting '10 years' for '5 years', and

(II) shall apply whether or not distributions of the employee's interests have begun in accordance with subparagraph (A).

(ii) EXCEPTION FOR ELIGIBLE DESIGNATED BENEFICIARIES.—Subparagraph (B)(iii) shall apply only in the case of an eligible designated beneficiary.

(iii) RULES UPON DEATH OF ELIGIBLE DESIGNATED BENEFICIARY.—If an eligible designated beneficiary dies before the portion of the employee's interest to which this subparagraph applies is entirely distributed, the exception under clause (ii) shall not apply to any beneficiary of such eligible designated beneficiary and the remainder of such portion shall be distributed within 10 years after the death of such eligible designated beneficiary.

(iv) SPECIAL RULE IN CASE OF CERTAIN TRUSTS FOR DISABLED OR CHRONICALLY ILL BENEFICIARIES.—In the case of an applicable multi-beneficiary trust, if under the terms of the trust—

(I) it is to be divided immediately upon the death of the employee into separate trusts for each beneficiary, or

(II) no individual (other than a eligible designated beneficiary described in subclause (III) or (IV) of subparagraph (E)(ii)) has any right to the employee's interest in the plan until the death of all such eligible designated beneficiaries with respect to the trust,

for purposes of a trust described in sub-clause (I), clause (ii) shall be applied separately with respect to the portion of the employee's interest that is payable to any eligible designated beneficiary described in subclause (III) or (IV) of subparagraph (E)(ii); and, for purposes of a trust de-scribed in subclause (II), subparagraph (B)(iii) shall apply to the distribution of the employee's interest and any beneficiary who is not such an eligible designated ben-eficiary shall be treated as a beneficiary of the eligible designated beneficiary upon the death of such eligible designated beneficiary.

(v) APPLICABLE MULTI-BENEFICIARY TRUST.—For purposes of this sub-paragraph, the term 'applicable multi-beneficiary trust' means a trust—

(I) which has more than one beneficiary,

(II) all of the beneficiaries of which are treated as designated beneficiaries for purposes of determining the distribution period pursuant to this paragraph, and

(III) at least one of the beneficiaries of which is an eligible designated beneficiary described in sub-clause (III) or (IV) of subparagraph (E)(ii).

(vi) APPLICATION TO CERTAIN ELIGIBLE RETIREMENT PLANS.—For purposes of applying the provisions of this subparagraph in determining amounts required to be distributed pursuant to this paragraph, all eligible retirement plans (as defined in section 402(c)(8)(B), other than a defined benefit plan described in clause (iv) or (v) thereof or a qualified trust which is a part of a defined benefit plan) shall be treated as a defined contribution plan.

CAN A CRT STRETCH AN INHERITED IRA?

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Table of Contents

I. Overview

A testamentary transfer of taxable retirement assets from a retirement account to a charitable remainder trust ("CRT") means that the retirement assets will ultimately be transferred from the CRT to a charity. But there is a time lag between the time that the CRT is funded and the charity receives the assets. And that time lag can last for more than ten years. During that time period, the full value of the retirement assets, without any diminution for income taxes, can be held by the CRT to generate income for distributions. First to individuals, and then to charities.

The advantage that a CRT offers over any other type of trust that an estate planner might draft is that a CRT is exempt from the income tax. A transfer at death from a retirement plan to a CRT is a tax-free transfer of assets from one tax-exempt trust to another tax-exempt trust.

If this is the arrangement that a retirement account owner wants, then the documents must be properly drafted or else there could be significant income tax problems. First, the owner should identify the type of CRT (CRUT ? FLIPCRUT? CRAT? etc.) and should select the various options that best meet his or her objectives. For example, should the trust exist for a term of years or for a beneficiary's life? Then the retirement account beneficiary designation forms should be drafted to name the tax-exempt CRT as the beneficiary. The CRT should be legally entitled to receive the IRD contained in the retirement account. In oversimplified terms, the objective is that when the assets are ultimately distributed from the retirement account to the CRT, the Form 1099-R should correctly report the distribution as being made to a tax-exempt CRT.

Two risks that should be avoided are: (1) that income will somehow be taxed to an estate or to a taxable trust and (2) that the trust might fail to qualify as a CRT because of a drafting error or for some other reason. This paper will identify these risks and will identify steps to successfully structure a bequest of retirement assets to a CRT without triggering adverse tax consequences.

The strategies outlined in this article focus on transferring taxable income in respect of a decedent ("IRD") to a CRT. When a retirement account has little or no IRD, such as a Roth IRA, the appeal of a CRT isn't much greater than funding a conventional testamentary CRT with conventional assets, such as stocks and bonds.

II. IRAs and Qualified Retirement Plans

A. OBJECTIVES - Keep the largest amount in an IRA or QRP, so you can earn investment income on the deferred income taxes in the account. EXAMPLE:

	Principal	10% Yield		5% Yield	
Amount in IRA	$100,000	10%	$ 10,000	5%	$ 5,000
Income Tax on Distribution (40%)	40,000				
Amount Left to Invest	$ 60,000	10%	$ 6,000	5%	$ 3,000

In order to force QRP and IRA accounts to be used to provide retirement income, Congress enacted two significant penalties. First, there is a 10% penalty tax for most distributions before age 59 ½. Section 72(t). Second, there is a 50% penalty tax imposed on the account owner for not receiving the required minimum distribution ("RMD"). § 4974; Reg. § 54.4974-2. The penalty is imposed during one's lifetime after attaining the age of 72 or retiring, whichever occurs later. The 50% penalty tax also applies after the account owner's death to beneficiaries who fail to receive the post-death minimum amounts.

B. REQUIRED LIFETIME DISTRIBUTIONS AFTER AGE 72 [previously age 70 ½]

GENERAL RULES – Unless you are married to someone who is more than ten years younger than you, there is one -- and only one -- table of numbers that tells you the portion of your IRA, 403(b) plan or qualified retirement plan that must be distributed to you each year after you attain the age of 72. The only exception to this table is if (1) you are married to a person who is more than ten years younger than you and (2) she or he is the only beneficiary on the account. In that case the required amounts are even less than the amounts shown in the table. To be exact, the required amounts are based on the joint life expectancy of you and your younger spouse.
Note: There were no RMDs in the year 2020. The CARES Act eliminated RMDs for the year.

–*YEAR 2021* --UNIFORM LIFETIME DISTRIBUTION TABLE –

Age	*Payout*						
70	-0-	80	5.35%	90	8.78%	100	15.88%
71	-0-	81	5.59%	91	9.26%	101	16.95%
72	3.91%	82	5.85%	92	9.81%	102	18.19%
73	4.05%	83	6.14%	93	10.42%	103	19.24%
74	4.21%	84	6.46%	94	10.99%	104	20.41%
75	4.37%	85	6.76%	95	11.63%	105	22.23%
76	4.55%	86	7.10%	96	12.35%	106	23.81%
77	4.72%	87	7.47%	97	13.16%	107	25.65%
78	4.93%	88	7.88%	98	14.09%	108	27.03%
79	5.13%	89	8.33%	99	14.93%	109	29.42%

[Table computed from Table A-2 of Reg. § 1.401(a)(9)-9 (2002) -- (rounded up)]

TWO SIMPLE STEPS:
Step 1: Find out the value of your investments in your retirement plan account on the last day of the preceding year. For example, on New Years Day -- look at the closing stock prices for December 31.
Step 2: Multiply the value of your investments by the percentage in the table that is next to the age that you will be at the end of this year. This is the minimum amount that you must receive this year to avoid a 50% penalty.

> Example: Ann T. Emm had $100,000 in her only IRA at the beginning of the year. She will be age 80 at the end of this year. In the year 2021, she must receive at least $5,350 during the year to avoid a 50% penalty (5.35% times $100,000). If she had attained age 80 in the year 2022, she would only need to receive at least $4,950 during the year to avoid a 50% penalty (4.95% times $100,000). Please see the table below.

– *Year 2022 and later* --UNIFORM LIFETIME DISTRIBUTION TABLE –

Age	*Payout*						
70 ½	-0-%	80	4.95%	90	8.27%	100	15.63%
71	-0-%	81	5.19%	91	8.78%	101	16.95%
72	3.67%	82	5.44%	92	9.26%	102	17.86%
73	3.79%	83	5.69%	93	9.91%	103	19.24%
74	3.93%	84	5.96%	94	10.53%	104	20.41%
75	4.07%	85	6.25%	95	11.24%	105	21.74%
76	4.22%	86	6.58%	96	12.05%	106	23.26%
77	4.39%	87	6.95%	97	12.83%	107	24.39%
78	4.57%	88	7.36%	98	13.70%	108	25.65%
79	4.77%	89	7.76%	99	14.71%	109	27.03%

C. MAXIMUM YEARS FOR PAYOUTS AFTER ACCOUNT OWNER'S DEATH: TEN YEARS, FIVE YEARS, OR A REMAINING LIFE EXPECTANCY

Failure to receive the required minimum distribution ("RMD") for that year from an inherited retirement account triggers a 50% penalty on the shortfall. The maximum time period over which a decedent's account may be liquidated without such a penalty after the year of death is either:
(#1) ten years, if only "designated beneficiaries" ("DBs") (or a "look-through trust" with 100% DBs) are the beneficiaries of the account (there is no RMD until the 10th year), § *401(a)(9)(H)(i)*
(#2) the remaining life expectancy of an eligible designated beneficiary ("EDB"), based on the EBD's age at the end of the year that follows the account owner's death. An EDB is a beneficiary who is: a surviving spouse, a minor child of the decedent, disabled, chronically ill, or someone who is not more than ten years younger than the decedent (there is an RMD every year), §§ *401(a)(9)(H)(ii), (E)(ii) & B(iii)*
(#3) five years(there is no RMD until the 5th year)**,** if the account owner died before the required beginning date ("RBD") and there is even just one non-DB on the "determination date" (generally, September 30 following the year of death), §§ *401(a)(9)(B)(ii) and (H)(i)("Except in the case of...);Reg.* § 1.401(a)(9)-3 Q&A 4*;* or
(#4) the life expectancy of someone who was the account owner's age (a/k/a a **"ghost life expectancy")** if the account owner died after the RBD and there is even just one non-DB on the "determination date." There will be RMDs in each of those years. §§ *401(a)(9)(B)(i) and (H)(i); Reg.* § 1.401(a)(9)-5 Q&A 5(c)(3)

YEAR 2021 LIFE EXPECTANCY TABLE

Age	Life Expectancy	Age	Life Expectancy	Age	Life Expectancy	Age	Life Expectancy	Age	Life Expectancy
0	82.4	20	63.0	40	43.6	60	25.2	80	10.2
1	81.6	21	62.1	41	42.7	61	24.4	81	9.7
2	80.6	22	61.1	42	41.7	62	23.5	82	9.1
3	79.7	23	60.1	43	40.7	63	22.7	83	8.6
4	78.7	24	59.1	44	39.8	64	21.8	84	8.1
5	77.7	25	58.2	45	38.8	65	21.0	85	7.6
6	76.7	26	57.2	46	37.9	66	20.2	86	7.1
7	75.8	27	56.2	47	37.0	67	19.4	87	6.7
8	74.8	28	55.3	48	36.0	68	18.6	88	6.3
9	73.8	29	54.3	49	35.1	69	17.8	89	5.9
10	72.8	30	53.3	50	34.2	70	17.0	90	5.5
11	71.8	31	52.4	51	33.3	71	16.3	91	5.2
12	70.8	32	51.4	52	32.3	72	15.5	92	4.9
13	69.9	33	50.4	53	31.4	73	14.8	93	4.6
14	68.9	34	49.4	54	30.5	74	14.1	94	4.3
15	67.9	35	48.5	55	29.6	75	13.4	95	4.1
16	66.9	36	47.5	56	28.7	76	12.7	96	3.8
17	66.0	37	46.5	57	27.9	77	12.1	97	3.6
18	65.0	38	45.6	58	27.0	78	11.4	98	3.4
19	64.0	39	44.6	59	26.1	79	10.8	99	3.1

Table A-1 of Reg. § 1.401(a)(9)-9 (“single life ”), required by Reg. § 1.401(a)(9)-5, Q&A 5(a) & 5© and Q&A 6.

LIFE EXPECTANCY TABLE - Years 2022 and later

Age	Life Expectancy	Age	Life Expectancy	Age	Life Expectancy	Age	Life Expectancy	Age	Life Expectancy
0	84.5	20	65.0	40	45.7	60	27.1	80	11.2
1	83.7	21	64.0	41	44.7	61	26.2	81	10.5
2	82.7	22	63.0	42	43.8	62	25.3	82	9.9
3	81.7	23	62.0	43	42.8	63	24.5	83	9.2
4	80.8	24	61.1	44	41.8	64	23.6	84	8.6
5	79.8	25	60.1	45	40.9	65	22.8	85	8.1
6	78.8	26	59.1	46	39.9	66	22.0	86	7.5
7	77.8	27	58.2	47	39.0	67	21.2	87	7.0
8	76.8	28	57.2	48	38.0	68	20.4	88	6.6
9	75.8	29	56.2	49	37.1	69	19.5	89	6.1
10	74.8	30	55.3	50	36.1	70	18.7	90	5.7
11	73.8	31	54.3	51	35.2	71	17.9	91	5.3
12	72.8	32	53.4	52	34.3	72	17.1	92	4.9
13	71.9	33	52.4	53	33.1	73	16.3	93	4.6
14	70.9	34	51.4	54	32.4	74	15.6	94	4.2
15	69.9	35	50.5	55	31.5	75	14.8	95	3.9
16	68.9	36	49.6	56	30.6	76	14.0	96	3.7
17	67.9	37	48.6	57	29.7	77	13.3	97	3.4
18	66.9	38	47.6	58	28.8	78	12.6	98	3.2
19	66.0	39	46.6	59	27.9	79	11.9	99	3.0

D. REQUIRED DISTRIBUTIONS AFTER DEATH-- Definitions

Required Beginning Date ("RBD") **-** The first date that a distribution must be made from an IRA, QRP or 403(b) account to the account owner in order to avoid the 50% penalty tax.[1]

> ***IRAs*:** The RBD for an IRA is April 1 following the calendar year that the IRA account owner attains age 72.[2]
>
> ***QRP or 403(b)***: The RBD for a qualified retirement plan or a tax-sheltered annuity is the *later* of (a) April 1 following the calendar year that the account owner attains age 72 or (b) April 1 following the calendar year that the employee separates from service (e.g., somebody who works past age 73).[3] Individuals who own 5% or more of a business are not eligible for this later RBD: their RBD is April 1 following the calendar year that they attain age 72.

*"**Beneficiaries" versus "Designated Beneficiary" ("DB")*** - A beneficiary is any person or entity that is entitled to receive benefits from a QRP or IRA account after the account owner's death. By comparison, a *designated beneficiary* is an *individual* who is entitled to the benefits of the IRA or QRP account upon the death of the employee / participant / IRA owner (hereafter "account owner").[4] Neither a charity nor the decedent's estate will qualify as a DB since neither has a life expectancy. If certain criteria are met, a trust may be the beneficiary of an IRA or QRP and distributions will be based on the beneficiaries of that trust (a "look-through trust").

"Eligible Designated Beneficiary" ("EDB") **-** An EDB qualifies for an exception to the general ten liquidation rule. An EDB may receive distributions over his or her the remaining life expectancy of an eligible designated beneficiary ("EDB"), based on the EBD's age at the end of the year that follows the account owner's death. An EDB is a beneficiary who is: a surviving spouse, a minor child of the decedent (though upon attaining majority age, the ten year rule applies), disabled, chronically ill, or someone who is not more than ten years younger than the decedent.[5]

Determination Date - The minimum distributions will be computed based only on the beneficiaries who still have an interest on the determination date. That date is September 30 of the calendar year that follows the calendar year of the account owner's death.[6] Example: Sarah died on September 14, 2021, the determination date for her IRA and QRP accounts will be September 30, 2022.

The five year liquidation period that existed before the SECURE Act continues to apply if there is a beneficiary that is not a "designated beneficiary" on the determination date. (See the text below). Other beneficiaries will then not be eligible for a ten year liquidation time period.

There are basically three ways to eliminate some of the beneficiaries before the determination date: (1) disclaimers, (2) cash-out of a beneficiary and (3) separate accounts for different beneficiaries.[7]

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[1] ***Sub-Paragraph "H" was added by the SECURE Act, effective Jan 1, 2020***:
(H) SPECIAL RULES FOR CERTAIN DEFINED CONTRIBUTION PLANS.—In the case of a defined contribution plan, if an employee dies before the distribution of the employee's entire interest—
(i) IN *GENERAL*.—*Except* in the case of a beneficiary who is *not* a designated beneficiary, subparagraph (B)(ii)—
(I) shall be applied by substituting '10 years' for '5 years', and
(II) shall apply whether or not distributions of the employee's interests have begun in accordance with subparagraph (A).

E. REQUIRED MINIMUM DISTRIBUTIONS FROM IRAs AND QRPs AFTER THE ACCOUNT OWNER'S DEATH, BASED ON THE BENEFICIARIES AS OF THE "DETERMINATION DATE"

BENEFICIARY	DEATH BEFORE RBD	DEATH AFTER RBD
"*No designated beneficiary* ("DB")" - if there is even just one non-human beneficiary (e.g., probate estate or a charity)	Five Years *[No RMD until the 5th year]*	Remaining life expectancy of someone who was the *decedent's age* in the year of death ("ghost life expectancy") *[RMDs must be made each year]*
NON-SPOUSE DESIG. BENIF.		
General Rule if all beneficiaries are individuals ("DBs")	Ten Years *[No RMD until the 10th year]*	- Same: Ten Years - * * An argument can be made that the term can be the "ghost life expectancy," if that is more than ten years
Rollover option?	Not available to anyone but a surviving spouse.**	** - Possible to transfer decedent's account from a company plan (but not from an IRA) to an IRA payable over ten years (or life expectancy of an EDB)
Eligible Designated Beneficiary ("EDB")	Remaining life expectancy of the *EDB*,* fixed as of the year *after* death. Distributions must begin before the end of the year that follows the year of death. *[RMDs must be made each year]*	– Same Rule – * - (if the EDB is older than the deceased, use life expectancy based on the deceased's age)
Beneficiaries include both EDBs and non-EDBs	Unless separate shares are established, generally Ten Years (or Five Years). Special rules benefit accumulation trust for disabled & chronically ill.	Ten Years (or remaining life expectancy of someone who was the *decedent's age*) [unless separate shares; special rules benefit disabled & chronically ill]
SPECIAL RULES		
"Look-through"trust/ "See-through" trust	"Look through" to identity of DBs and EDBs of the trust to determine RMDs.	– Same Rule --
Remainder beneficiary	A remainder beneficiary is counted as a beneficiary of an *accumulation trust*, but not of a *conduit trust*	– Same Rule –

BENEFICIARY	**DEATH BEFORE RBD**	**DEATH AFTER RBD**
SPOUSE IS THE BENEFICIARY		
Rollover Option?	Yes, available	Yes, available
Leave in deceased's account and spouse is the sole beneficiary?		
-- General Rule	**Minimum distributions over the surviving spouse's remaining life expectancy, *gradually extended* each year as the spouse ages.**	**– Same Rule --**
-- IRAs only: elect to treat as own IRA	**Surviving spouse can elect to leave assets in deceased's IRA but treat that IRA like a rollover IRA.**	**– Same Rule --**
-- Decedent died before age 72?	**Can defer first distribution until the year that the deceased spouse would have been age 72.**	**Not applicable**
MULTIPLE DBs; ONE IS THE SPOUSE		
Both spouse and another DB are the beneficiaries	Generally ten years, unless separate shares are established.	– Same Rule --
Both spouse and a charity are beneficiaries	Five Years, unless separate accounts are established for the beneficiaries.	Remaining life expectancy of someone who was the *decedent's age*, unless separate accounts for the beneficiaries.
"Look-through" trust/ "See-through" trust	Generally ten years, since "look through" to identity of the beneficiaries. If payable to a conduit trust, then the remaining life expectancy of the spouse.	– Same Rule --
Remainder beneficiary	A remainder beneficiary is counted as a beneficiary of an *accumulation trust*, but not of a *conduit trust*	– Same Rule –

III. CRTs

A. Overview

A bequest of a retirement account to a CRT means that the retirement assets will ultimately be transferred from the CRT to a charity. But there is a time lag before the charity receives the assets. And that time lag can last for much more than just ten years. During that time period, the full value of the retirement assets, without any diminution for income taxes, can be held by the CRT to generate income for distributions. First to individuals, and then to charities.

The advantage that a CRT offers over any other type of trust that an estate planner might draft is that a CRT is exempt from the income tax. A transfer at death from a retirement plan to a CRT is a tax-free transfer of assets from one tax-exempt trust to another tax-exempt trust. The tax-exempt feature of a CRT makes it a very attractive recipient of a bequest of any source of IRD, including non-qualified deferred compensation plan assets,[8] employee stock options,[9] savings bonds,[10] unpaid wages,[11] and post-death payments under promissory notes from installment sales.[12]

B. Tax-Exempt Status of CRTs

Like a qualified retirement plan account, a CRT is exempt from the income tax.[13] No matter how much income a CRT may earn in a year, no tax is paid until a distribution is made to a taxpaying beneficiary.

The one exception is if a CRT holds an asset that generates unrelated business taxable income ("UBTI"). The CRT must pay a confiscatory 100% tax on the full amount of the UBTI.[14] The asset that is most likely to generate UBTI is a partnership interest or an LLC interest of a commercial business.[15] Debt-financed investment property can also trigger UBTI,[16] but such property would usually not be received as a distribution from a retirement plan account.

C. How Long ? Term of Years or for Life?

A CRT's term may exist for the lives of one or more individuals or for a fixed term of years (maximum 20). The requirement that there must be a minimum 10% charitable deduction (described at *infra* below in Part III.F.2) means, as a practical matter, that it is difficult to establish a CRT that lasts for the life of a beneficiary under age 27 or for the lives of multiple beneficiaries under age 38. For very young beneficiaries, a CRT for a term of years is the only option.

A CRT for a term of years will also provide the greatest assurance to people who are most interested in having distributions last for more than ten years. If a beneficiary of such a CRT dies before the term has been completed, then distributions can be made to successor beneficiaries.[17] By comparison, if a CRT is established for the life of a single beneficiary who dies within a year after the CRT was funded, then the assets in the CRT will be immediately transferred to a charity. Family members may feel that they would have been better off with a simple ten year liquidation of the inherited retirement account. Mortality risk with a CRT that will last for the life of a beneficiary can be reduced by naming multiple lifetime beneficiaries of the CRT and by using life insurance in conjunction with the funding of the CRT.

D. Choosing the Trustee and the Charity

Whereas many living grantors to CRTs also act as the trustee of the CRT, this is not possible with a testamentary CRT that will receive retirement assets. Consequently, it is important to select a competent trustee who can administer a testamentary CRT that could last for the lives of multiple CRT beneficiaries, or a for term of up to 20 years. An institutional trustee could provide greater competence and longevity compared to an individual named as trustee. At the very least, the trust instrument should name an institution that is willing to administer the CRT as a successor trustee in the event that an individual trustee resigns. Some commercial trust companies will not administer a CRT that holds less than $200,000, although some charities are willing to administer a CRT with minimum assets of $100,000.

It is also important to identify a charity that is likely to be in existence to receive the CRT's assets when the trust terminates. Since a CRT might last for as long as 50 years, it would be helpful to list stable, established charities as contingent beneficiaries in the event that the primary charity has gone out of existence.

One charitable strategy that may be appealing to many donors is to have the CRT terminate into donor advised funds that will be advised by the donor's descendants (e.g, grandchildren). This arrangement may be particularly attractive when a testamentary CRT will only last for a term of years. The CRT could terminate into donor advised funds that will make charitable grants based on the grant recommendations made by the same individuals who had received distributions during the term of the CRT (in most cases, the donor's children and grandchildren). Such an arrangement will be most effective in a family that has instilled a spirit of philanthropy and has educated descendants on effective grant-making use of donor advised funds.[18]

The same philanthropic strategy could work if the CRT liquidates into a private foundation. It is possible for a CRT to itself become a private foundation when the distributions to non-charitable beneficiaries terminate.[19]

E. Choosing the Best Type of CRT - CRATs, CRUTs, FLIPCRUTs, NIMCRUTs

1. Definitions

There are five types of CRTs:

1. *Charitable Remainder Annuity Trust* ("CRAT")[20] - A trust that pays a *fixed dollar amount* (at least 5% and no more than 50% of the value of the property contributed to the trust) each year to one or more income beneficiaries for life (or for a fixed term of years -- maximum 20) and then the remaining proceeds are distributed to one or more charitable organizations.

2. *Charitable Remainder Unitrust* ("Standard CRUT")[21] - A trust that pays a *fixed percentage* (at least 5% and no more than 50%) of the value of the trust's assets each year (redetermined annually) to one or more income beneficiaries for life (or for a fixed term of years -- maximum 20) and then the remaining proceeds are distributed to one or more charitable organizations.

3. *Charitable Remainder Net-Income Unitrust* ("NICRUT")[22] - A trust that pays the *lesser* of that year's net income or a fixed percentage (between 5% and 50%) of the value of the trust's assets each year (redetermined annually) to one or more income beneficiaries for life (or for a fixed term of years -- maximum 20) and then the remaining proceeds are distributed to one or more charitable organizations. A trustee may insist on a net-income limitation when a donor contributes an illiquid asset, such as real estate, that doesn't generate enough cash to make the annual required distributions of 5% or more. NICRUTs are rarely established -- donor's prefer NIMCRUTs or FLIPCRUTs.

4. *Charitable Remainder Net-Income With Make-up Unitrust* ("NIMCRUT")[23] - A NIMCRUT is a NICRUT with a "make-up" provision in the trust instrument. The trust can pay in excess of the stated payout percentage to the income beneficiary in order to make up any shortfall from a prior year when the net income limitation caused the beneficiary to receive an amount that was less than the stated payout. For example, if a NIMCRUT with a stated 5% payout only earns 3% of net income in its first year, it would only distribute 3% to the income beneficiary. If in the second year it earned 8%, it could distribute 7% to the income beneficiary: 5% for the stated percentage plus a 2% make-up amount for the reduced distribution in the first year (oversimplified).

5. *Flip Unitrust* ("FLIPCRUT")[24] - A FLIPCRUT is a unitrust that begins as a NICRUT or a NIMCRUT but converts into a standard CRUT the year after a specified date or a "triggering event" occurs. This is the most popular type of CRT for receiving illiquid assets that may take a while to sell, such as real estate or closely-held stock. The triggering event is usually defined to be the sale of the illiquid asset. When it converts to a standard CRUT, the trust will usually hold liquid investments that can easily be sold to make the required distributions.

2. Which will work best?

The principal difference between a CRAT and a CRUT is that the former requires a fixed dollar payout and the latter requires a fixed percentage payout. Estate planners usually recommend a lifetime CRUT for a young individual because of the possibility that payments may gradually increase over a long time span if the CRUT's investments increase in value. If the value of the CRUT's investments fall in any given year, then the distributions for that year will decline as well.

A CRAT might be perceived as a more desirable option if the CRT will last for a short time period, such as for a term of years or for the remaining life of an elderly beneficiary. The fixed CRAT payments will not fluctuate with the changing value of potentially volatile investments that are held by the CRAT. Such steady payments can give many people a level of comfort. But they offer no protection against inflation. Furthermore, the minimum 5% annual distribution using assumed investment returns of 2% or less means that they cannot have a projected life of more than 20 years. This doesn't offer much additional tax deferral compared to the 10-year liquidation time period for liquidating an inherited retirement account.

A FLIPCRUT might be the best choice when a retirement account holds an illiquid asset that cannot produce the required annual CRT distributions of 5 percent (or more).[25] The trust instrument can provide that the triggering event will be the sale of that asset, in which case the trust "flips" into a standard CRUT in the following year.[26] A FLIPCRUT can also serve as a retirement income vehicle. For example, the trust instrument can provide that the triggering event will be the beneficiary's 66th birthday.[27] The FLIPCRUT can invest in low-yield growth assets that produce little distributable income and then convert to higher yield assets after the trust flips.

Some estate planners have suggested using a NICRUT or a NIMCRUT that holds its assets in an LLC that distributes smaller amounts of income in earlier years and larger amounts in later years.[28]

F. CRT Requirements That Can Pose Challenges to Estate Planners

There are many technical rules that apply to CRTs. For example, the CRT beneficiary can have the power to change which charity will receive the remainder interest, and the CRT trustee should not promise to invest in tax exempt bonds. In the author's experience, the following issues are the ones that most frequently pose challenges to structuring a gift to a CRT.

1. Annual payouts between 5% and 50%

The minimum annual distributions from a CRT to its beneficiaries is 5 percent of the value of the assets.[29] A CRT cannot have a stated percentage of 3 percent or 4 percent, even though several states have adopted a 4 percent default rule under their state statutes for unitrusts and net-income trusts.

The minimum 5 percent distribution requirement has been an administrative challenge in the low interest rate environment of the past dozen years. Trustees often sell some assets in order to make the required distributions, which usually isn't a tax problem since the trust is tax-exempt. The only way to distribute less than 5 percent is if the trust instrument contains a net-income limitation (that is, the CRT is a NICRUT, a NIMCRUT or a FLIPCRUT).

2. Minimum 10% charitable deduction

a. The requirement

The value of the charity's remainder interest of a CRT must be at least 10 percent of the initial net fair market value of all property placed in the trust, computed using the Section 7520 discount rates in effect at the time of contribution.[30] Since a CRUT (unlike a CRAT) can receive several contributions over time, the 10 percent requirement must be met every time that a contribution is made to a new or pre-existing CRUT.[31] If a contribution is made to a trust that fails the 10 percent requirement, the trust will not qualify as a tax-exempt CRT.[32]

b. Impact on payout or the projected term of trust

Oversimplified, there are two ways that the present value of a charity's remainder interest in a CRT can be less than 10 percent of the value of the property that was contributed to the trust. The first is if the stated payout rate is too high (e.g., "for the next 20 years, distribute to my child 30 percent of the trust's assets each year"). The solution is to lower the CRT's payout rate, but it cannot be lowered below 5 percent. Many CRT agreements contain clauses that provide that if the rate stated in the trust instrument is too high, then the CRT's distribution percentage rate will be automatically reduced to whatever rate is necessary to satisfy the 10 percent requirement. Other agreements simply state that the distribution percentage will be whatever the maximum permitted rate is in the month that the trust is funded.[33]

The second way is if the projected term of the trust is too long. For example, if you invest $5 today and earn 3 percent interest every year for the next 100 years, then the $5 will grow to $100 in 100 years. Thus, the present value today of receiving $100 in 100 years is just 5 percent, which is less than 10 percent. The 10 percent requirement limits the projected term of a CRUT to a maximum of roughly 55 years.

This makes it hard (impossible?) in the low interest rate environment of 2021 to establish a CRUT that would last for the life of any individual under age 28. The problem is particularly challenging for a CRAT, where there can be a greater impact caused by the large spread between the fixed distribution amount (that must be at least 5 percent of the value of the contributed property) and the assumed investment return of the assets in the trust (in the year 2021, the Section 7520 rate was never higher than 2.4 percent). For example, in the year 2021, a CRAT could not be established to make distributions for the life of anyone under age 78![34] In fact in 2021, a person could not establish a term of years CRAT with a 20 year term – the maximum permissible term was 19 years.

Things become even more challenging when there are multiple beneficiaries. The projected life expectancy for the last-to-die of a group of individuals increases as more individuals are added to the pool. For example, if in 2021 there was only one beneficiary of a CRUT, then the 10 percent test was met with a beneficiary as young as age 28. If there were two beneficiaries who were the same age (e.g., husband and wife), then they had to be at least age 39. The comparable minimum ages for a CRAT was considerably higher: one beneficiary (age 78); two beneficiaries who were the same age (both must be at least age 80).

What can an estate planner do if the beneficiaries are so young that a CRT fails the 10 percent test? One strategy is to create multiple CRTs. For example, if a client has three children who are triplets and each is age 28, there could be three CRTs (one for each child) rather than a single CRT. Another option is to have a CRT for a term of years. A term of years CRT would permit distributions to be made over more than the 10 year time limit for liquidating an inherited retirement account, but not longer than the 20 year term limit permitted for such a CRT.

c. Multiple beneficiaries - and what about the grandchildren ?

Most CRT governing instruments provide that when there are multiple concurrent lifetime beneficiaries of the CRT and one beneficiary dies, then future distributions will be divided among the surviving beneficiaries. Thus, if a CRT distributes \$3,000 monthly to three children (\$1,000 per child) and one child dies, most trust instruments will provide that thereafter the \$3,000 will be divided among the two surviving children (\$1,500 apiece). The last surviving beneficiary would receive monthly distributions of \$3,000 until death, at which point the CRT would terminate and the trust's assets would be distributed to the charitable beneficiaries.

For those individuals who want their retirement assets to benefit their grandchildren, there are a variety of options. The first is to abandon the CRT idea and leave retirement assets outright to both children and grandchildren, recognizing that the inherited retirement accounts will have to be liquidated in ten years.

The second is to establish a CRT that benefits the children for a term of years (maximum 20 years), rather than for the lives of the children. A terms of years CRT can contain per stirpes provisions that would operate in the event of an early death of one of the children. The trust will qualify as either a CRAT or a CRUT, regardless of the identity or age of the beneficiaries, since it will terminate at the end of a fixed term.[35]

Anytime there is a possible payment to a grandchild, an estate planner should consider the possible impact of the generation skipping tax[36] if the estate will be large enough to trigger a federal estate tax liability. A CRT cannot be the source of payment of estate tax liabilities,[37] and proper GST allocations or alterative tax payment arrangements should be implemented. As will be illustrated later, there can also be income tax challenges when retirement assets of an estate that is subject to the federal estate tax are used to fund a CRT.[38]

d. Term of years CRT

By naming a term of years CRT as the beneficiary of a retirement account, distributions of retirement assets (and the income that they generate) could be made to the decedent's beneficiaries for a term longer than the 10 year period that generally applies to an inherited retirement account, but not longer than the 20 year limit permitted for a term of years CRT. Upon the CRT's termination, the trust's remaining assets would be distributed to the charitable remainderman. As mentioned above, an attractive beneficiary might be donor advised funds that will be advised by the same individuals who had benefitted from the assets in the CRT over the CRT's term.[39]

There are disadvantages with a high-payout CRUT (e.g., "each year distribute 11% of the assets"). The beneficiary of a high-payout CRUT will likely receive deceasing amounts every year since the distribution rate will usually exceed the annual investment return earned by the trustee. Although the amount of each year's distribution from a CRAT would remain the same throughout the term of the CRAT, the problem for the beneficiary of a 20 year CRAT is the effect of inflation. For example, if inflation is 2% per year, then the last fixed payment at the end of a 20 year term would have the purchasing power of just 67% of the first year's payment.[40]

A maximum-payout term-of-years CRUT will usually make a final distribution to the charitable remainderman that is much less than the original contribution to the CRUT. The only way that the trust's assets could increase is if the CRUT could consistently earn more than the high stated payout percentage. For example, if the trustee can only earn the Section 7520 rate, the assets in a maximum-payout term-of-years CRUT that begins with $100,000 should fall to between just $12,000 and $16,000 by the time the trust terminates.

This can impact a trustee's decision to agree to serve as the trustee of such a CRUT. To make the administration of a high-payout CRUT economically viable, the trust would have to begin with considerably more assets than just the $100,000 or $200,000 minimum amount often cited by commercial trustees. The other option is to reduce the stated payout percentage to a rate closer to what the trustee projects could be earned on the trust's assets (but not lower than the minimum 5 percent required for a trust to qualify as a CRT). Using a 5 percent distribution rate when the CRUT can steadily earn 7 or 8 percent would permit growing payments to the beneficiary and a large distribution to the charity when the term ended

3. Avoid multiple donors to a single CRT

The Service concluded in a 1995 private letter ruling that a CRUT that would be funded by multiple contributors (two grandparents and six grandchildren) would fail to qualify as a valid CRT.[41] The Service's logic was that the joint transfers had the effect of the donors acting as associates in an association (taxable as a corporation rather than a trust) that "pooled their assets with an object to carry on business and divide the gains therefrom." The safe-harbor CRT documents released in 2005 seem to reiterate the Service's policy against multi-donor CRTs, but allowed an exception for a multi-donor CRT that was established with contributions from both a husband and a wife.[42]

4. Private foundation self-dealing rules apply to CRTs

A CRT is subject to some of the private foundation excise taxes.[43] The CRT's trust instrument should specifically state that it will not engage in transactions that violate these excise taxes.[44] The provision that comes up most often is the prohibition on self-dealing. Beneficiaries should not borrow or buy from, or lend or sell to, the CRT since that would be a violation of the self-dealing rules of Section 4941.

5. Problematic assets

a. Partnership interests

When a CRT owns a partnership or an LLC interest, it is deemed to be engaged in the underlying activities of that partnership or LLC.[45] Thus, if a partnership or an LLC is engaged in a commercial business activity, then a tax exempt organization that owns an interest in that partnership or LLC must report its share of those profits as UBTI.[46]

Only the portion of the income that is attributable to a partnership's or LLC's unrelated commercial activities is subject to UBIT. A tax-exempt organization usually will not pay any tax on its share of partnership income from passive investments, such as interest, dividends and capital gains.[47] Thus, holding a partnership interest or an LLC interest of an investment club, whose income consists entirely of interest, dividends and capital gains, should not trigger UBTI to a CRT, unless the investments were financed with debt.[48]

b. S corporation stock

A Section 401(a) retirement plan, such as an ESOP, is eligible to own S corporation stock.[49] A charity is also eligible to own S corporation stock.[50] But neither an IRA[51] nor a CRT is eligible to be a shareholder of an S Corporation. A transfer of S corporation stock to a CRT will terminate the corporation's Subchapter S tax status.[52] If a qualified plan holds S corporation stock and if that plan's assets will be transferred at death to a CRT, then the stock should be sold inside the qualified plan account and only the proceeds, rather than the S corporation stock, should be transferred to the CRT.

c. Debt-encumbered property

There are serious complications that discourage individuals from donating mortgaged property to a CRT. The donor has been relieved of a liability, perhaps triggering the private foundation self-dealing tax and perhaps causing the CRT to be reclassified as a grantor trust.[53]

G. Added Requirements for CRATs That Pose Challenges

1. Only one contribution possible

A trust fails to qualify as a CRAT unless its governing instrument states that no additional contributions may be made to the CRAT after the initial contribution.[54] This prohibition does not apply to a CRUT. Despite the prohibition, the tax regulations provide that "all property passing to a charitable remainder annuity trust by reason of death of the grantor shall be considered one contribution."[55] Thus, a testamentary CRAT could probably be funded with contributions from multiple retirement accounts as well as a bequest from an estate or from a grantor trust after the death of the settlor.[56] As is explained below in Part III.I.1, there can be income tax advantages if a separate CRT will receive retirement plan assets rather than commingling retirement assets with other assets in a CRT.

2. Five percent probability that CRAT's assets will not be exhausted

The IRS takes the position that no estate tax charitable deduction is allowed for a contribution to a CRAT that will make payments over someone's lifetime unless there is less than a 5 percent chance that the corpus will be exhausted.[57] The IRS did not want to allow a charitable deduction when it was possible that the annuity payments would consume all of the assets and nothing would be paid to a charity. This 5 percent probability test does not apply to a CRUT, nor does it apply to a CRAT that is payable over a fixed term of years.

In 2016, the Service offered a solution to this low-interest rate environment. In Revenue Procedure 2016-42 the Service permitted CRATs to be formed that would fail the 5% probability test if the governing instrument contained a "qualified contingency" that the trust would terminate immediately prior to making its next payment if distributing that payment would cause the trust principal to fall below 10% of the original value of the trust, plus interest.

H. Asset protection issues

In 2014, the Supreme Court concluded in a unanimous decision that an *inherited* IRA was not afforded the protection extended to "retirement funds" under bankruptcy law.[58] This development caused many estate planners to recommend that clients name as their IRA beneficiary a trust that contained spendthrift clauses.

A typical spendthrift clause prohibits a creditor from seizing a beneficiary's interest in a trust and prohibits the beneficiary from voluntarily or involuntarily assigning his or her interest in the trust to anybody else. Often the trustee has the discretion to avoid making distributions from the trust to a beneficiary. This power might be exercised when there is a creditor who is ready to seize each and every distribution that leaves the trust payable to the beneficiary.

With the requirement that inherited IRAs must be liquidated in just ten years, naming a tax-exempt CRT as the IRA's beneficiary is becoming an attractive option compared to naming a conventional taxable trust. If a CRT has no spendthrift clause, the interest of a beneficiary can be seized by creditors. But a CRT can contain spendthrift clauses. To the extent that these clauses are effective, they could prevent a creditor from seizing the CRT beneficiary's interest and prevent the CRT beneficiary from assigning his or her interest in the CRT to somebody else.

On the other hand, a CRT trustee is subject to very rigid requirements that distributions must be made each year pursuant to the instructions in the trust instrument. Once a distribution leaves a trust, it can be seized by a creditor. When there is just one beneficiary of a CRT, there is not the flexibility that a trustee could have with a conventional trust to withhold distributions to the beneficiary. Failure to make the required distributions can disqualify the CRT.[59]

Finally, there is concern that the spendthrift clauses might not be effective. In 2014, a bankruptcy court held that the broad spendthrift clause contained in a mother's trust did not prevent creditors from seizing a share of the trust's assets when one of the mother's four children filed a petition in bankruptcy.[60]

I. Four-tier system for income distributions to beneficiaries

1. Overview

Instead of the usual pass-through rules that apply to distributions from conventional trusts, distributions from charitable remainder trusts are subject to a "four tier" system. The distribution regime is commonly referred to as WIFO ("worst-in, first-out"). The income that is subject to the highest tax rates will be distributed from the trust before income that qualifies for lower tax rates can be distributed. Thus, all of the ordinary income from both the current year and from all prior years must be fully distributed from the first tier before a single dollar of capital gain income is distributed from the second tier, and so on.

The four-tier system provides that distributions from a charitable remainder trust shall have the following characteristics to the income beneficiary:[61]

(1) First, as amounts of income (other than capital gains) to the extent of such income for that year and undistributed income of the trust for all prior years;

(2) Second, as a capital gain to the extent of the capital gain for the year and the undistributed capital gain of the trust for all prior years;

(3) Third, as other income (such as tax-exempt municipal bond interest) to the extent of such income for the year and such undistributed income of the trust for all prior years; and

(4) Fourth, as a distribution of trust corpus.

Within each tier, there are layers of income. For example, the tax rate on the long-term capital gain from selling a collectible asset (e.g., a painting) can be as high as 28% but the long-term capital gain tax rate on the gain from selling a share of corporate stock is no more than 20%. Hence, following the WIFO principle, all current and prior-year collectible gains must be distributed in full from a CRT before a single dollar of 15%/20% long-term capital gain can be distributed. Most investment income in the first and second tiers can be potentially subject to the 3.8% surtax on net investment income,[62] but distributions from qualified retirement plans and IRAs are *not* subject to the 3.8% surtax.[63]

A CRT that was established after 2012 and that holds inherited retirement assets will report distributions to the beneficiary as coming from income from the following sources in the following sequence (income marked with an asterisk ("*") is exempt from the 3.8% surtax) :[64]

Tier 1 - **<u>Ordinary income</u>**	**Tier 2 -** **<u>Capital Gains</u>**	**Tier 3 -** **<u>Tax-exempt income</u>**	**Tier 4 -** **<u>Corpus</u>**
1. Taxable interest	1. Short-term capital gain (Ordinary income tax rate)	1. Current year's tax-exempt interest and other tax-exempt income*	1. Section 691(c) income tax deduction for IRD deposited into a CRT (per PLR 199901023 - see *infra* Part III.I.4)*
2. Net rents	2. Collectible gain (max 28% rate)	2. Accumulated tax-exempt interest and other tax-exempt income from prior years*	2. Capital contributions to the trust*
3. Annuity and royalty income	3. Building 1250 recapture gain (max 25% rate)	*(* no 3.8% surtax on tax-exempt income)*	*(* no 3.8% surtax on distributions of tax-exempt corpus)*
4. Dividends (non-qualified)	4. Other long-term capital gain (15% or 20% rate)		
5. Retirement income* *(* no 3.8% surtax on IRA/QRP distribution)*	5. NUA capital gain* (15%/20% tax, and *also exempt from 3.8% surtax)*		
6. Dividends (qualified-15%/20% tax rate)			

2. Implications for IRD

If a CRT is funded only with assets received from an IRA or QRP, then the CRT beneficiary likely won't receive dividends or long-term capital gains that would be taxed at the advantageously lower rates of 15% or 20% for at least 15 or 20 years. The entire amount of taxable IRD from the retirement account will be classified as first-tier income rather than fourth-tier corpus.[65] Even if all of the CRT's assets were invested in stocks and municipal bonds, it could take 15 or 20 years for a CRT with a 5 percent payout (5% times 20 = 100%) to completely distribute the IRD that was deposited into the CRT and thereby permit some lower-taxed qualified dividend income or long-term capital gain income to be distributed. Consequently, investing in lower-yielding tax-exempt bonds makes little sense for a CRT that was funded with retirement assets.

The four tier system also affects the decision of whether to add *non*-retirement assets to such a CRT. Rather than commingle IRD with a deposit of non-IRD assets (stocks, bonds, mutual funds, etc.) in a single CRT, it may be advisable to have a separate CRT for the IRD assets, particularly when there is a very large retirement accumulation of several hundred thousand dollars. The large amount of first-tier IRD will prevent the distribution of dividend or capital gain income generated from the investment of the non-IRD assets that were deposited in the trust. If, instead, there are two CRTs, a person can receive from one CRT the retirement income IRD (taxed as ordinary income but exempt from the 3.8% health care surtax) and have the chance of receiving dividends and long-term capital gains, taxed at rates as low as 15%, from the other CRT. The threshold issue is whether the potential income tax savings to the beneficiary will outweigh the cost of administering two CRTs.

As a service to upper-income beneficiaries who could be subject to the 3.8% surtax, the trustees of both CRTs and conventional trusts should point out in very strong terms that the IRD from retirement distributions is exempt from the surtax. Unless that is done, many upper-income beneficiaries will likely mistakenly pay the 3.8% surtax on CRT distributions of retirement income that is actually exempt from the surtax.

3. Long-term capital gain treatment for NUA

When employer stock is received as a lump sum distribution from a Section 401 qualified retirement plan, the net-unrealized appreciation ("NUA") can qualify for long-term capital gain treatment when the stock is sold. Unlike other capital gains, the NUA gain is exempt from the 3.8% surtax.[66]

4. Challenges when federal estate tax was paid

a. Overview

What happens to the Section 691(c) deduction when a retirement account is part of an estate that paid the federal estate tax? As an oversimplified example, if the sole contribution to a testamentary CRT was $1,000,000 from an IRA that was subject to the 40% federal estate tax, PLR 199901023 would classify $600,000 as first-tier ordinary income and the $400,000 (which would normally qualify for the Section 691(c) income tax deduction for the federal estate tax that was paid) as fourth-tier corpus.[67] The only way that any of the $400,000 could be distributed to a beneficiary of the CRT would be if the $1,000,000 CRT shrank to less than $400,000 of assets.

b. Tax planning implications

If the Service sticks to this approach, then in most cases it is better to abandon the IRA-to-CRT strategy for wealthy individuals whose estates will be subject to the federal estate tax.

Instead, a wealthy individual would be better advised to leave some or all of the pre-tax retirement assets outright to charities at death. The combination of federal estate and income taxes (plus in some states the estate and income taxes of the state) can consume as much as 80% of the IRD. Many people will prefer to leave 100% of the assets to a charitable purpose that they have selected rather than leave 80% to the governments in taxes. If there is a large amount of IRD, there may be sufficient assets to justify the cost of establishing a private foundation. By comparison, donor advised funds can provide philanthropic involvement by descendants at a much lower cost, while still avoiding both estate and income taxes.

For those with no charitable intent, it may be better to leave the retirement assets outright to beneficiaries rather than have the assets transferred to a CRT. An outright bequest to beneficiaries will permit them to claim the Section 691(c) income tax deduction to offset the taxable income from the IRD. Thus, a $100 distribution received from an inherited retirement account will only produce $60 of taxable income (oversimplified). By comparison, leaving the retirement assets to a CRT effectively strips away that income tax deduction by placing the deduction in the fourth tier. The $100 distribution received from the CRT will produce $100 of taxable income.

J. Charitable lead trusts are not tax-exempt

Another type of split-interest charitable trust is a charitable lead trust ("CLT).[68] Donors are usually attracted to such trusts because, in addition to charitable grants, they can provide estate and gift tax benefits. Unlike a CRT, a CLT is *not* exempt from the income tax. Either the trust (for a "non-grantor CLT")[69] or the donor (for a "grantor CLT")[70] will be subject to income tax on the trust's income. Hence, a CLT is a lousy beneficiary of IRD. The income tax burden will significantly shrink the CLT's assets and will reduce whatever other benefits that a CLT could provide.

CONCLUSION

Naming a charitable remainder trust as the beneficiary of a retirement plan is a way that a charitably inclined individual can use the pre-tax assets in a retirement account to benefit both charity and family. The circumstances that are most likely to provide the best income tax consequences for the family are (a) an anticipated long-term CRT (e.g., 30 years or more) and (b) anticipated high income tax rates imposed on income in respect of decedent.

ENDNOTES

1. § 4974; Reg. § 54.4974-2, Q&A 1 and 2; § 401(a)(9)(C)(i).

2. § 408(a)(6); Reg. § 1.408-8 Q&A 3.

3. § 401(a)(9)©; Reg. § 1.401(a)(9)-2, Q&A 2.

4. § 401(a)(9)(E)(i); Reg. § 1.401(a)(9)-4, Q&A 1.

5. § 401(a)(9)(E)(ii)

6. Reg. § 1.401(a)(9)-4, Q&A 4.

7. If a beneficiary's interest is eliminated between the time that the account owner died and the determination date – for example by a cash out or a disclaimer -- then that beneficiary will not impact the required minimum distributions. PLR 200740018 (July 12, 2007).

8. See Private Letter Rulings 200002011 (Sept. 30, 1999) and 200012076 (Dec. 29, 1999) (outright charitable bequests of nonqualified deferred compensation amounts).

9. *Id.,* also addressed the income tax aspects of charitable bequests of employee stock options.

10. There is no taxable income to an estate when savings bonds are transferred to a charity upon the owner's death. Private Letter Ruling 9845026 (August 11, 1998). If the charity is a private foundation, then it will be liable for the 1%/2% excise tax on the interest income. Rev. Rul. 80-118, 1980-1 C.B. 254.

11. Reg. § 1.691-2(b). Damages recovered by heirs for a decedent's back pay is IRD. *Carr Est. v. Commissioner*, 37 T.C. 1173 (1962).

12. Such payments are IRD. § 453B(c); Reg. § 1.691(a)-5. See also Rev. Rul. 78-32, 1978-1 C.B. 198 where the IRS concluded that if a sale is completed after the seller's death, then payments are income in respect of a decedent if most of the terms of the sale had been agreed to before death.

13. A CRT is tax-exempt under Section 664(c)(1), whereas charities and qualified plans are tax-exempt under Section 501(a).

14. Section 664(c)(2); Reg. § 1.664-1(c).

15. Section 512(c); Reg. § 1.512(c)-1. See also *Service Bolt & Nut Co. Profit Sharing Trust v. Commissioner*, 724 F.2d 519 (6th Cir. 1983) (retirement plan's 90% ownership interest in limited partnership that distributed fasteners was taxable, even though the plan physically did no work).

16. §§ 512(b)(4) and 514; Treas. Reg. § 1.514(b)-1(a). The tax problems associated with debt-encumbered investment property are described further at *infra* Part III.F.5.

17. Rev. Rul. 74-39, 1974-1 C.B. 156.

18. The education process can begin during the donor's lifetime. The donor can establish donor advised funds for the children and grandchildren and educate them on philanthropy. Many organizations require a minimum of only $10,000 to establish a donor advised fund. The parent/grandparent can lead by example and identify the charitable interests that were most important to him or to her. The children and grandchildren in such a situation will likely do a better job with the resources in the donor advised fund than others who learn about donor advised funds for the very first time upon the termination of a CRT.

19. Treas. Reg. § 1.664-2(c)(6)(ii). As a practical matter, the CRT would need to have considerable assets to justify the costs of administering a private foundation.

20. I.R.C. § 664(d)(1); Treas. Reg. § 1.664-2.

21. I.R.C. § 664(d)(2); Treas. Reg. § 1.664-3.

22. I.R.C. § 664(d)(3)(A); Treas. Reg. § 1.664-3(b).

23. I.R.C. § 664(d)(3)(B); Treas. Reg. § 1.664-3(b).

24. Treas. Reg. § 1.664-3©.

25. See, for example, Michael Jones and Michelle Ward, "Alternative Investments in IRAs", *Trusts and Estates Magazine* (June, 2 Treas. Reg. § 1.664-3(c). The legal standard for the conversion is that it must be "triggered on a specific date or by a single event whose occurrence is not discretionary with, or within the control of, the trustees or any other persons." Treas. Reg. § 1.664-3(a)(1)(i)(c)(1). The sale of an illiquid asset, such as real estate, might be considered to be within the discretionary control of the trustee. However, the regulations provide a safe harbor that "a triggering event based on the sale of unmarketable assets ... or the marriage, divorce, death, or birth of a child with respect to any individual will not be considered discretionary with, or within the control of, the trustees or any other persons." Treas. Reg. § 1.664-3(a)(1)(i)(d).

26. *Id.*

27. *Id.* ("a specific date").

28. Jonathan G. Blattmachr, Matthew D. Blattmachr, and Richard L. Fox, *Using a Charitable Remainder trust as the Recipient of Qualified Plan and IRA Interests*, 47 Estate Planning Journal #5 (May 2020).

29. I.R.C. §§ 664(d)(1)(A) (CRAT) and 664(d)(2)(A) (CRUT)

30. I.R.C. §§ 664(d)(1)(D) (CRAT) and 664(d)(2)(D) (CRUT). The test is applied on the date that the property is placed into the trust rather than on the date that the trust was created. Reg. § 1.664-2(c).

31. § 664(d)(2)(D). If an existing CRUT receives a new contribution that fails the 10% test, there is no affect on the existing assets of the trust but for federal tax purposes the new contribution will be treated as a transfer to a separate trust that is not a CRT. § 664(d)(4).

32. *Id.*

33. Rather than state the specific payout percentage in the trust instrument, it is possible to draft a formula clause in the trust instrument so that the exact payout rate will be determined at the time that the trust is funded. This is especially helpful for a testamentary CRT. The § 7520 rates could change so much between the time that a trust instrument is drafted and the time that a CRT is actually funded after the settlor's death that the fixed percentage that was stated in the trust agreement could be too high for the trust to pass the 10 percent charitable value test. Something akin to: *The Trustee shall pay, in each taxable year of the unitrust, a unitrust amount equal to the "payout percentage" multiplied by the net fair market value of the trust assets, as finally determined for federal tax purposes, valued as of the first day of each taxable year of the unitrust. The "payout percentage" shall be the highest rate allowable for this trust to qualify as a charitable remainder trust under § 664 of the Internal Revenue Code of 1986, as amended.* Thus, for example, if a 65 year old used this language in a testamentary CRUT for the benefit of a 33 year old child, the payout percentage would be 5.78% if the 65 year old died immediately but would be 7.66% if he or she died 10 years later and the child was then 43 years old. This computation was made assuming a 2.2% § 7520 rate (a common rate between 2012 and 2019) would also be in effect 10 years later. Is that likely to occur?

34. By comparison, the CRUT computations assume the payout computation will be based on a gradually shrinking pool of assets in the CRUT each year, so a higher stated payout is permitted.

35. See *supra* Part III.E.2.b for a range of possible distribution percentages that vary with the term of a CRAT or a CRUT.

36. I.R.C. §§ 2601 through 2652.

37. I.R.C. §§ 664(d)(1)(B) and 664(d)(2)(B).

38. See *infra* Part III.H.4.

39. See *supra* Part III.D.

40. Computed as: 1/(1.02 ^ 20th power) = 67.3%.

41. PLR 9547004 (Aug. 9, 1995).

42. "*Identity of donor*. For purposes of qualification under this revenue procedure, the donor may be *an individual* <u>or</u> *a husband and wife*. Appropriate adjustments should be made to the introductory paragraph if a husband and wife are the donors." (emphasis added by author). Rev. Proc. 2005-54, 2005-2 C.B. 353 , Section 5.01(5)

(annotations).

43. A CRT is subject to the excise taxes on "self-dealing" and "taxable expenditures," but is usually exempt from the excise taxes on excess business holdings and jeopardy investments. I.R.C. §§ 4947(a)(2) and (b)(3).

44. Treas. Reg. § 1.664-1(b), citing I.R.C. § 508(e).

45. "The activities of an LLC *treated as a partnership* for federal income tax purposes are considered to be the activities of a nonprofit organization that is an owner of the LLC when evaluating whether the nonprofit organization is operated exclusively for exempt purposes within the meaning of I.R.C. § 501(c)(3)." Rev. Rul 98-15, 1998-1 C.B. 718. This would not be the case, however, if the LLC elected to be treated as a corporation taxed under Subchapter C.

46. § 512(c); Reg. § 1.512(c)-1. See also *Service Bolt & Nut Co. Profit Sharing Trust v. Commissioner*, 724 F.2d 519 (6th Cir. 1983) (retirement plan's 90% ownership interest in limited partnership that distributed fasteners was taxable, even though the plan physically did no work).

47. Reg. § 1.512(c)-1; See also S. Rep. No. 1402, 85th CONG., 2d SESS. 2 (1958), reprinted at 1958-1 C.B. 656, 657. Interest, dividends, and capital gains are generally excluded from UBTI. §§ 512(b)(1), (3) and (5) and Reg. § 1.512 The exception would be if the investment income was generated by debt-financed property, described *infra* , at Part III.F.5.c.

48. Debt-financed income of a partnership passes through to a tax-exempt partner. § 514(c)(9)(B)(vi). See *infra* Part III.F.5.c for debt-financed UBTI.

49. § 1361(c)(6).

50. *Id.*

51. An IRA is generally not eligible to be a shareholder of an S corporation. See the last sentence of Treas. Reg. § 1.1361-1(h)(1)(vii) and *Taproot Administrative Services v. Commissioner*, 133 T.C. 202 (2009).

52. The IRS rejected creative arguments that a CRT could perhaps qualify as an S corporation shareholder. Rev. Rul. 92-48, 1992-1 C.B. 301; Private Letter Ruling 8922014 (June 2, 1989) (a CRT cannot be a QSST); § 1361(e)(1)(B)(iii) (a CRT cannot be an ESBT). There have been several mistaken transfers of S corporation stock to CRTs and the Service has forgiven the transgressions as "inadvertent terminations" provided that the transactions were undone. Private Letter Rulings 200819009 through 200818013(Jan. 11, 2008); 200704026 and 200703023 (Oct. 16, 2006) and PLR 199908046 (Nov. 19, 1998). Even if a CRT could be a shareholder, any S corporation income that was classified as UBTI would cause the CRT to incur a 100% tax liability because a CRT is subject to a 100% tax rate on UBTI. § 664(c)(2).

53. Reg. § 1.664-1(a)(6); Private Letter Rulings 9533014 (May 15, 1995) and 9015049 (Jan. 16, 1990) (when a CRT makes payments on a mortgage for which the donor remains liable, the CRT could be a "grantor trust" and thereby fail to qualify as a CRT - see Reg. § 1.677(a)-1(d)).

54. Treas. Reg. § 1.664-2(b).

55. *Id.*

56. In a private letter ruling the IRS concluded that a testamentary CRAT could receive contributions from both the settlor's estate and the settlor's inter vivos trust without violating the "additional contributions rule "because all properties passing to the charitable remainder annuity trust by reason of the death of the settlor are considered one contribution." Private Letter Ruling 8121108 (Feb. 27, 1981).

57. Revenue Ruling 77-374, 1977-2 C.B. 329.

58. *Clark v. Rameker*, 573 U.S. (2014).

59. When a trustee failed to make any required distributions to the life beneficiary, the Tax Court and the 11th Circuit Court of Appeals held that the trust failed from its inception to qualify as a CRT. *Estate of Atkinson*, 309 F.3d 1290 (11th Cir. 2002).

60. *In re Castellano*, 2014 WL 3881338 (Bk.N.D.Ill., Aug. 6, 2014).

61. § 664(b); Treas. Reg. § 1.664-1(d)(1)(I) (general rules) and 1.1411- 3(d) (the 3.8% net investment income tax – rules for CRT distributions).

62. § 1411(a)(1) imposes a surtax of 3.8 percent on the *lesser* of (A) an individual's net investment income or (B) the amount by which the individual's modified adjusted gross income exceeds the threshold amount of $250,000 (married joint returns; $125,000 if file separately) or $200,000 for all other returns (single or head of household).

63. § 1411(c)(5), Treas. Reg. § 1.1411- 8.

64. Modified from example contained in Treas. Reg. § 1.1411- 3(d)(2)(ii), Example 1. A CRT's accumulated income from before the year 2013 is exempt from the 3.8% surtax on net investment income, but most investment income after 2012 is subject to the surtax. Treas. Reg. § 1.1411-3(d). To simplify things, this table ignores pre-2013 income.

65. Private Letter Ruling 199901023 (Oct. 8, 1998).

66. Treas. Reg. § 1.1411-8(b)(4)(ii).

67. Actually, no more than $360,000 of federal estate tax would qualify for the § 691(c) deduction, since the estate would be able to claim at least a 10% charitable estate tax deduction on the federal estate tax return. For simplicity, though, the example uses $400,000 to make it is easier for the reader to follow the numerical illustration.

68. A charitable lead trust is the inverse of a CRT: the trust pays amounts to a charity for a period of years and then the remainder interest is distributed to non-charitable beneficiaries, typically family members related to the original donor. The charity's income interest must be either a guaranteed annuity of fixed payments (a charitable lead annuity trust, or "CLAT") or annual distributions of a percentage of the fair market value of the trust's property, revalued annually (a charitable lead unitrust, or "CLUT"). I.R.C. § 170(f)(2)(B)(income tax); I.R.C. § 2055(e)(2)(estate tax); I.R.C. § 2522(c)(2)(B)(gift tax).

69. I.R.C. § 642(c)(1). Such a trust may be able to claim offsetting charitable deductions for distributions that are required to be made to charities.

70. I.R.C. § 671.

Personal Ethics and Cybersecurity

FZ TECH

1

Why is Cybersecurity an Ethical Obligation?

- It is your ethical responsibility to protect your client's data
- Nearly all cyber attacks are now a breach of confidential data
- The most likely scenario to expose your client data is a cybersecurity breach (25% of all legal firms have had a breach- ABA)
- Every one of you is a target
- Every one of you has technology which is vulnerable

2

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Security+ Network+ A+ & CISSP
Many Other Certs..

FZ TECH

3

Goals

- Discuss types of attacks
- Provide action items to protect yourself
- Provide a list of things to NOT do
- Encourage you to think different about your technology use

4

Organizational Security vs Personal Security

Not everyone is a decision maker at your organization

Everyone has technology vulnerable to attack

5

Organizational security IS personal security

6

YOU Are a Target

- Attacks are against people - not technology
- Smaller companies
- Personalized
- Your Info is known
- ALL levels of staff

7

WE are the weakest link

No amount of technology can stop an attack if system users are not on alert!

8

Why are they out to get you?

- Money (Ransom – Extortion)
- Information (Identity)
- Organizational Access
- Launching point

9

Extortion

- All data has value
- How much would you pay to keep it from being permanently lost?
- How much would you pay to keep it from being exposed?

10

Organizational Access

- Criminals know your career and position
- Any level or position has value
- Your organization or others
- Remote access

11

Launching Point

- Email Compromise
- “Bot” to launch attacks on others
- Access to work via remote connection

12

What does an attack look like?

13

Attacks:

- Ransomware
- Extortion and Data Theft
- Business Email Compromise
- Mobile Device Attacks

14

Ransomware

15

Ransomware Today

Planned | more $$$ | negotiation | Data breach | NOT GETTING YOUR STUFF

16

Business Email Compromise - B.E.C.

- Goal is to get into your mailbox - then attack someone else
- All levels of staff
- Difficult to detect
- Get money from staff, clients and vendors

17

Connectivity Attacks

- Bluetooth
- WIFI
- NFC

18

Connectivity attacks mean the criminal needs to be “connected” to you

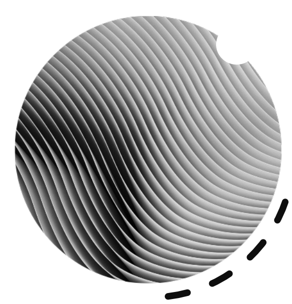
19

Content Attacks

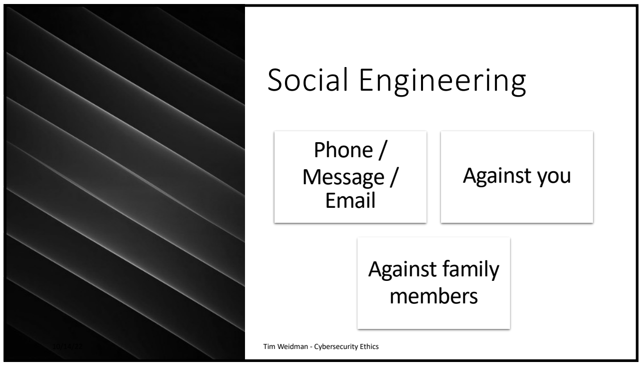
Web surfing

Phishing

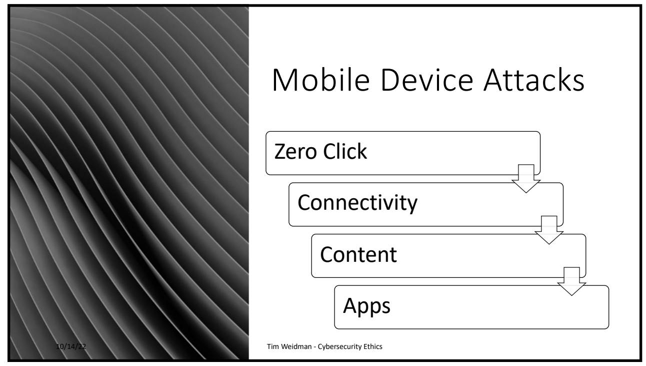
Links and Attachments



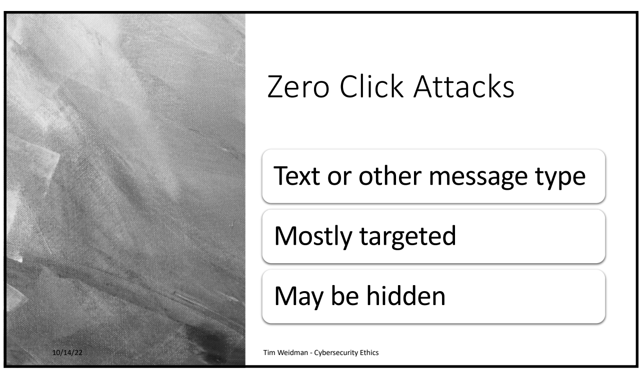
20


Social Engineering
Phone / Message / Email
Against you
Against family members
Tim Weidman - Cybersecurity Ethics

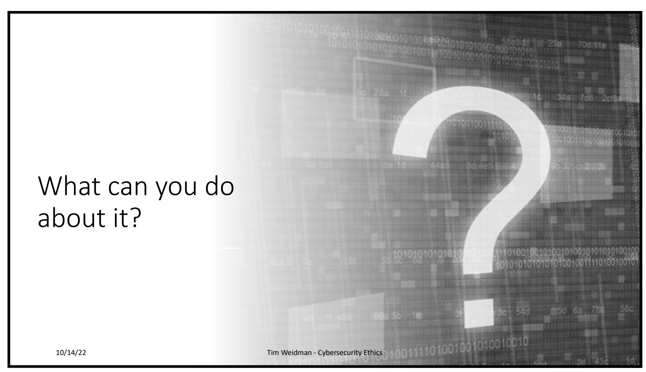
21


Mobile Device Attacks
Zero Click
Connectivity
Content
Apps
10/14/22
Tim Weidman - Cybersecurity Ethics

22


Zero Click Attacks
Text or other message type
Mostly targeted
May be hidden
10/14/22
Tim Weidman - Cybersecurity Ethics

23


What can you do about it?
10/14/22
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24

Manage Your Passwords

- NEVER reuse
- No personal info
- Strong password
- Password Manager
- This includes "PIN"

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25

The #1 thing each of you can do to prevent an attack is the thing that half of you will NOT do

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26

The one thing ONLY YOU control

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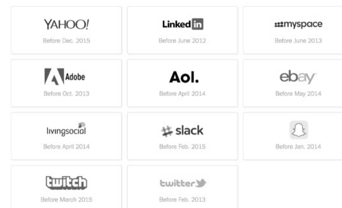
27

28

Known Password Attacks

29

Thousands of Password Breaches



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Known Password Attacks

- 55% of users have the same password on business and personal accounts
- Millions of stolen records and passwords
- Many sites have admitted to passwords being exposed
- Many attacks go undetected

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Assume EVERY Password You have EVER Used is Known

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Physical Security

- Never leave device unattended
- Enable "Find My Device"
- Avoid others having access to your devices
- Encrypt Everything (Bitlocker)
- Never store passwords with device

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Always use MFA

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Tips to a Safer Mobile Device

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App Security

Mobile Anti-Malware	Stay up to date (auto)
Remove old apps	Review app permissions

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Anti Malware

- AVAST
- Webroot
- Bitdefender
- Trend Micro

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Data Security

- Backup to the Cloud
- Be prepared to wipe device and start over
- Make sure to wipe before disposal
- Be careful what you store on the device

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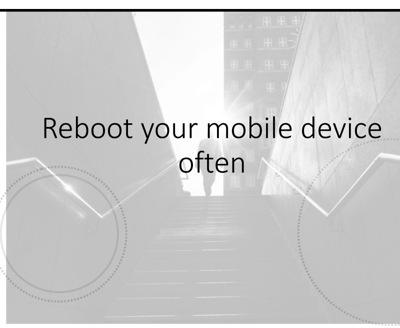

Reboot your mobile device often

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Things to Always Never Do

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Things to Always Never Do
CLICK LINKS ON EMAIL OR TEXT
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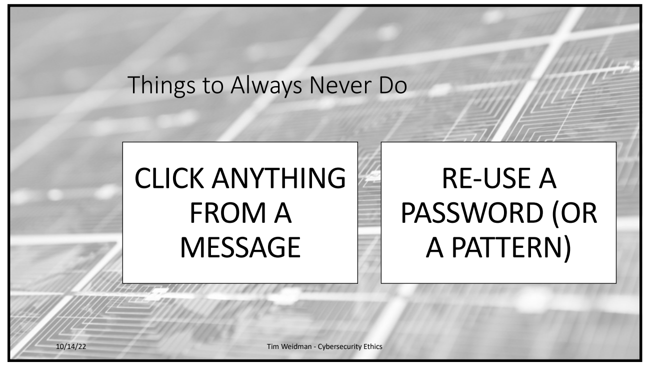
Things to Always Never Do
CLICK ANYTHING FROM A MESSAGE
RE-USE A PASSWORD (OR A PATTERN)
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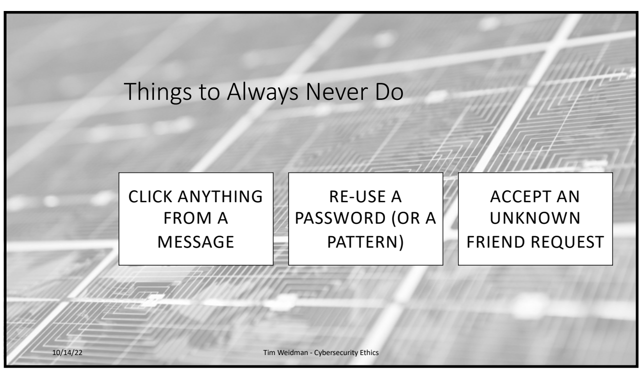
Things to Always Never Do
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RE-USE A PASSWORD (OR A PATTERN)
ACCEPT AN UNKNOWN FRIEND REQUEST
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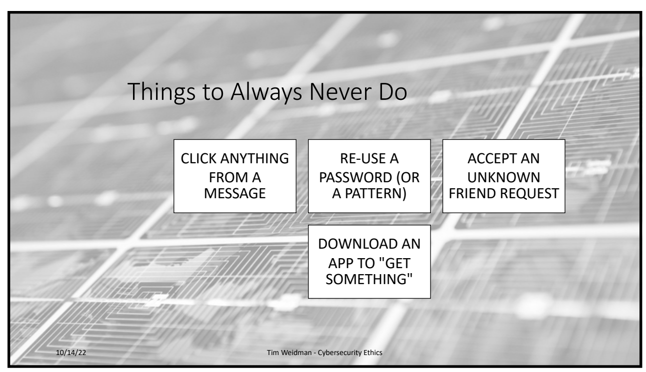
Things to Always Never Do
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ACCEPT AN UNKNOWN FRIEND REQUEST
DOWNLOAD AN APP TO "GET SOMETHING"
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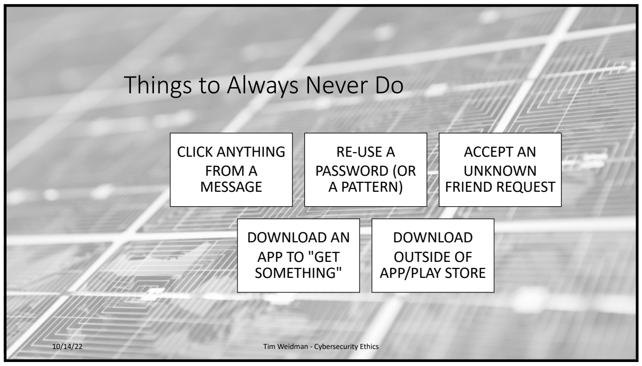
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DOWNLOAD OUTSIDE OF APP/PLAY STORE
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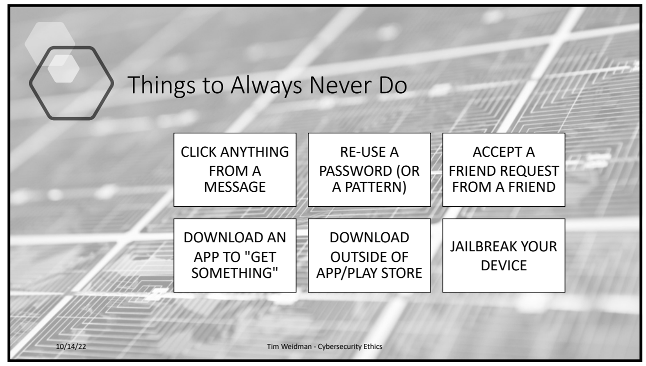
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JAILBREAK YOUR DEVICE
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Questions
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